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Supreme Court, U.S.
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No. 06-434 SEP 22 2006

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In The
Supreme Court of the United States

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CENTRAL TELEPHONE COMPANY,

Petitioner,

v.

E. NORRIS TOLSON, SECRETARY OF REVENUE, STATE OF NORTH CAROLINA,

Respondent.

◆

On Petition For A Writ Of Certiorari To The North Carolina Court Of Appeals

◆

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Whether *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), *F.W. Woolworth Co. v. Taxation & Revenue Department of New Mexico*, 458 U.S. 354 (1982), *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992), and the Due Process and Commerce Clauses prohibit North Carolina's taxation of gains on the sales of investments in businesses in Iowa and Minnesota when those businesses had no connection to North Carolina.

Whether *Jones v. Flowers*, 126 S. Ct. 1708 (2006), requiring a state to provide Constitutionally adequate due process before concluding a tax matter without addressing the merits of the case, requires North Carolina courts to have heard and decided the merits of Petitioner's challenge to North Carolina's taxation of those gains.

LIST OF PARTIES

The parties are as stated in the caption.

RULE 29.6 STATEMENT

Embarq Corporation owns 10% or more of Centel Corporation which owns petitioner Central Telephone Company. Embarq Corporation is a publicly traded corporation.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully seeks this Court's review of the November 15, 2005 decision of the North Carolina Court of Appeals and the June 29, 2006 denial of the Supreme Court of North Carolina to review the decision of the North Carolina Court of Appeals.

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OPINIONS BELOW

The order of the Supreme Court of North Carolina (App. A at 1a-2a), dated June 29, 2006, is reported at 360 N.C. 532. The opinion of the North Carolina Court of Appeals (App. B at 3a-11a), dated November 15, 2005, is reported at *Central Telephone Co. v. Tolson*, 621 S.E.2d 186. The order of the North Carolina Superior Court, Wake County (App. C at 12a-14a), dated June 3, 2004, is not reported. The decision of the North Carolina Tax Review Board (App. D at 15a-22a), dated June 4, 2002, is not reported. The Final Decisions of the Assistant Secretary of the North Carolina Department of Revenue (App. E at 23a-68a and App. F at 69a-78a) were issued on December 29, 2000 and November 19, 2001, and are not reported.

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JURISDICTION

The decision of the North Carolina Court of Appeals was rendered on November 15, 2005 (App. B at 3a). The North Carolina Supreme Court denied Petitioner's petition for discretionary review on June 29, 2006 (App. A at 2a). The North Carolina Court of Appeals issued an Order, dated July 26, 2006, certifying to the Clerk of the Superior Court, Wake County, that the North Carolina Supreme

Court allowed the Motion to Dismiss the Appeal and denied the Petition for Discretionary Review (App. G at 79a-80a). The jurisdiction of this Court rests upon 28 U.S.C. § 1257(a).

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CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The United States Constitution provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3 (the Commerce Clause).

The Fourteenth Amendment of the United States Constitution provides: "No State shall . . . deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1 (the Due Process Clause).

The relevant portion of the North Carolina statutes is set forth at App. H, *infra,* at 81a-95a.

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STATEMENT

The questions of whether (1) North Carolina can contravene *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), *F.W. Woolworth Co. v. Taxation & Revenue Department of New Mexico*, 458 U.S. 354 (1982), *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992), and the Due Process and Commerce Clauses of the United States Constitution to tax gains that are not connected to North Carolina and (2) North Carolina can contravene *Jones v. Flowers*, 126 S. Ct. 1708 (2006), and the Due Process Clause by avoiding the merits of the case are of paramount importance. For 14 years, multistate businesses have relied on this Court's decision in *Allied-Signal* for the limits of a state's right to apportion extraterritorial income. This issue has been pending in North Carolina for 14 years. It has contravened those limits and the North Carolina courts have refused to review the merits of this case.

Petitioner had local telephone businesses in four states, Iowa, Minnesota, Nevada and North Carolina. It ran them as separate businesses. In 1991, it sold the businesses that were in Iowa and Minnesota. North Carolina apportioned and taxed the gains from the sales of those businesses even though those businesses had no connection to North Carolina.

A. Petitioner's Businesses

As the North Carolina Court of Appeals said: "The facts giving rise to this appeal are undisputed." (App. B at 3a). Central Telephone Company ("Petitioner") was organized and incorporated in Delaware in 1970 and authorized to operate a local telephone company in North Carolina. (App. B at 3a-4a). In 1991, Petitioner's principal place of business was in Illinois. (*Id.*).

Petitioner operated the local telephone companies as independent divisions. Hearing Ex. T-1, Deloitte & Touche Report ("D&T Report") at 5.[1] The Iowa and Minnesota

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[1] All references to "Hearing Ex." and "Testimony" are to the Exhibit marked in evidence at, and the Transcript of, the Hearing

(Continued on following page)

companies were independent of Petitioner's North Carolina company. Each company maintained its own separate books and records. The companies were each separately regulated. The regulatory authorities required separate books and records for each company. The Iowa and Minnesota companies had their own officers. The North Carolina company had its own officers. None of Petitioner's North Carolina company's operating or administrative personnel contributed to the operating revenue derived from telephone services performed in Iowa or Minnesota. *Id.* at 5-6.

Petitioner's North Carolina company did not manage the accounts, assets or plants of the Iowa or Minnesota companies and Petitioner's North Carolina management was not involved in the management of the Iowa or Minnesota companies. Petitioner's North Carolina company had only North Carolina customers and was subject to the regulations of the North Carolina Utilities Commission. The Iowa and Minnesota companies had only Iowa and Minnesota customers, respectively, and were subject to regulatory bodies in Iowa and Minnesota, respectively. No company, North Carolina, Iowa or Minnesota, provided local telephone service or conducted any business outside the state in which it was located. *Id.*

Each of the local telephone companies had its own offices and handled the following functions, with occasional oversight from Petitioner's headquarters, but no involvement of the other local telephone companies: regulatory affairs, advertising, marketing, purchasing,

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before the North Carolina Secretary of Revenue held on August 16, 2000.

acquisitions, and human resources. There were no intercompany transactions between the North Carolina local telephone company and the Iowa and Minnesota local telephone companies. Exhibit 12 to Hearing Ex. T-1 (D&T Report); Bailor Testimony at 42-43; Samuelson Testimony at 60-62.

B. Gains from Iowa and Minnesota Businesses

In 1991, Petitioner sold the Iowa and Minnesota telephone companies to an unrelated third party. (App. B at 4a). In connection with the preparation of its 1991 North Carolina corporation income tax return, Petitioner, aware of this Court's 1982 Opinions in *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354 (1982), determined that including the gains from the sales of the unrelated Iowa and Minnesota companies in its North Carolina tax base would not fairly reflect the activities conducted by Petitioner in North Carolina.

If the gains are included in the general apportionment formula found in North Carolina General Statutes Section 105-130.4(n) (App. H at 90a-91a), Petitioner's North Carolina income in 1991 is $58,647,057. However, only $22,268,964 was properly attributed to its North Carolina activities, as demonstrated by Petitioner's North Carolina regulatory separate accounting records. That is, over two and one-half times the actual North Carolina income would be deemed attributable to North Carolina if the gains from the sales of the Iowa and Minnesota companies were included under the general apportionment method in that North Carolina statute.

C. Proceedings Below

1. The Separate Accounting Petition

A corporation may petition the North Carolina Augmented Tax Review Board ("Augmented Board") for permission to use an alternative apportionment formula if the general formula will operate or has operated to subject it to taxation on a greater portion of its income than is reasonably attributable to business or earnings from within North Carolina. On April 3, 1992, shortly before *Allied-Signal* was decided, Petitioner timely filed a petition with the Augmented Board under North Carolina General Statutes Section 105-130.4(t) requesting permission to use separate accounting to compute its 1991 North Carolina corporate income tax ("Separate Accounting Petition") since the Iowa and Minnesota businesses were separate and provided no local telephone services in North Carolina. Petition To Tax Review Board at 3 (Apr. 3, 1992).

The Augmented Board did not respond to Petitioner's Separate Accounting Petition until June 1995. In September 1992, the due date on extension of Petitioner's North Carolina 1991 corporate income tax return ("Return"), to avoid filing a late return (and the issues that arise from a late return, including interest and potential penalty), Petitioner timely filed its Return with the North Carolina Department of Revenue ("Department") and reported $58,647,057 of income to North Carolina. (App. E at 36a).

On June 16, 1995, more than three years after Petitioner filed the Separate Accounting Petition, the Augmented Board finally acted. It denied the Separate Accounting Petition. (App. I at 96a-97a).

On July 17, 1995, Petitioner timely filed a Petition for Judicial Review of the Separate Accounting Petition. The Department argued, successfully, to the North Carolina Superior Court Wake County that Petitioner was not entitled (and that no one is entitled) to judicial review of the Augmented Board's decision. On June 26, 2003, the North Carolina Superior Court of Wake County dismissed the Petition for Judicial Review without addressing the merits of Petitioner's arguments. (App. J at 98a-99a). Petitioner timely filed an appeal to the North Carolina Court of Appeals and on November 16, 2004, the Court of Appeals affirmed the Superior Court's dismissal without addressing the merits of Petitioner's arguments. 167 N.C. App. 14, 604 S.E.2d 680. It held that "there is no administrative appeal process from decisions made by the [Augmented Board]." (App. K at 115a).

Petitioner timely appealed to the Supreme Court of North Carolina and on February 3, 2005, the Supreme Court of North Carolina dismissed the appeal and denied review without addressing the merits of Petitioner's arguments. (App. L at 120a-122a, *In re Central Telephone Co.*, reported at 359 N.C. 281, 610 S.E.2d 203 (*Central Telephone I*)). No court ever reviewed the merits of Petitioner's Separate Accounting Petition.

2. The Refund Claim

While the Separate Accounting Petition appeal was pending, Petitioner pursued a refund claim on a parallel track. The refund claim is before this Court.

On July 17, 1995, Petitioner timely filed a claim for refund of the tax that it paid in September 1992 after the Augmented Board refused to act on Petitioner's April 3, 1992 Petition. Petitioner requested a hearing on its claim for refund. (App. E at 39a). The Department contended then – and it contends now – that Petitioner is not entitled to a hearing on the merits. The Department simultaneously argued that Petitioner was not entitled to judicial review of the Augmented Board's decision on the Separate Accounting Petition and that no hearing on the merits should be allowed on the claim for refund.

The Secretary of the Department disagreed and held a hearing on the refund claim. The Secretary entered into evidence ten exhibits for Petitioner, including the D&T Report, the expert reports of Professor Walter Hellerstein, Professor Richard Pomp and Richard Genetelli, C.P.A., 57 exhibits for the Department, and testimony. (App. E at 24a-33a; App. F at 71a).

Following the hearing, the Secretary denied Petitioner's refund claim in a Final Decision on December 29, 2000 (App. E at 68a), which was later supplemented on November 19, 2001. (App. F at 78a). The supplemental Final Decision noted that the "Secretary has no authority to rule on constitutional issues," *i.e.*, Petitioner's refund claim arguments under the Due Process and Commerce Clauses. (App. F at 72a).

From the Secretary's Final Decisions, Petitioner timely petitioned the Tax Review Board (which is the same as the Augmented Board, except the Department Secretary sits on the Augmented Board with the other Board members). On June 4, 2002, the Tax Review Board dismissed the petition on the refund claim. (App. D at 22a). It based its dismissal on the 1995 decision of the Augmented Board, the same decision (the 1995 decision of the Augmented Board) that the Department successfully argued in the North Carolina courts is not subject to judicial review.

The Tax Review Board did not review the merits of Petitioner's refund claim in its dismissal. Petitioner timely sought review of the Tax Review Board's dismissal in the North Carolina Superior Court Wake County. That court dismissed Central Telephone's petition for judicial review of the Tax Review Board's Decision and did not address the merits of Petitioner's refund claim. (App. C at 12a-14a).

Petitioner timely appealed to the North Carolina Court of Appeals. That court affirmed the Superior Court's dismissal and did not address the merits of Petitioner's refund claim. (App. B at 11a). Petitioner timely appealed to the Supreme Court of North Carolina. On June 29, 2006, the Supreme Court of North Carolina dismissed the appeal and denied review. (App. A at 1a-2a (*Central Telephone II*)).

No court has ever reviewed the merits of Petitioner's claim that *ASARCO*, *Woolworth*, *Allied-Signal*, and the Due Process and Commerce Clauses prohibit North Carolina's taxation of the gains from the sales of the Iowa and Minnesota businesses.

3. The Federal Questions Raised Below

Petitioner raised important federal questions concerning the protections of the Due Process and Commerce Clauses before the Secretary in the refund claim; that is: "whether North Carolina constitutionally was precluded from taxing the gains from the sales of the Iowa and Minnesota operating divisions as they were not part of petitioner's unitary business." (App. B at 5a). The Secretary determined that: "A refund based on this theory thus requires a ruling or declaration by the Secretary that inclusion of the income in the apportionable base is unconstitutional, and this I am without authority to do." (App. F at 75a).

The Tax Review Board did not address the merits of the federal questions. (App. D at 20a-22a). It said of itself: "The Regular Board, which is an administrative body, does not have authority or jurisdiction to rule upon the constitutionality of a statute. Thus, Taxpayer's constitutional claim is not an issue that the Regular Board is empowered to determine." (App. D at 22a (citation omitted)).

Petitioner preserved the federal questions at the Superior Court Wake County. (App. C at 12a). The Superior Court Wake County affirmed the Tax Review Board's dismissal with no analysis. (App. C at 13a-14a). It said the Tax Review Board's decision is "not in violation of constitutional provisions," (App. C at 13a), but it made no analysis and only reviewed the Tax Review Board's decision which expressly did not rule on the federal questions.

Petitioner preserved the federal questions for review at the North Carolina Court of Appeals; by stating: "the 1991 gain was not apportionable under the Due Process and Commerce Clauses of the United States Constitution." (App. B at 7a). That court did not reach the merits. (App. B at 11a).

Petitioner timely appealed to the Supreme Court of North Carolina and raised the federal questions. It said: "Is the Department prohibited by the United State Constitution from apportioning the extraterritorial gains arising from Central Telephone's sales of Iowa and Minnesota companies, which gains have no connection to, or relationship with, North Carolina?" Notice of Appeal at 3 (Dec. 19, 2005). It further said: "The decision of the Court of Appeals in this matter is in conflict with . . . decisions of the United States Supreme Court because: . . . The Department has violated the Due Process and Commerce Clauses of the United States Constitution and thereby contradicts the United States Supreme Court and this Court, which prohibit apportionment of extraterritorial income." Petition for Discretionary Review at 3 (Dec. 19, 2005).

On June 29, 2006, the Supreme Court of North Carolina dismissed the appeal and denied review and did not address the federal questions. (App. A at 1a-2a).

4. The Court of Appeals' Decision

The Court of Appeals' decision in *Central Telephone II*, the subject of this Petition, held that: (1) the Tax Review Board did not have to consider the merits of Petitioner's federal questions; (2) the unreviewed Augmented Board decision, which failed to address the merits of Petitioner's federal questions, was an adequate basis for the Tax Review Board's dismissal; (3) Petitioner could appeal by paying the tax and going to court – which Petitioner did (it paid the tax in 1992 and appealed to the court shortly after the 1995 Augmented Board decision);[2] (4) the Superior Court

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[2] The North Carolina courts and the Department appear to be taking the position that when Petitioner paid tax on the extraterritorial income amount in September 1992, which it paid solely because the Augmented Board had not ruled on the Separate Accounting Petition, Petitioner should have filed a claim for refund within 30 days after that payment of tax.

Petitioner maintains that it filed two claims for refund. First, the Separate Accounting Petition was in substance an immediate, concurrent

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Wake County could only review the issues decided by the administrative body below and since the Tax Review Board had not addressed the merits of Petitioner's federal questions, the Superior Court could not address the merits; and (5) that it (the Court of Appeals) did not need to address the merits of Petitioner's federal questions. (App. B at 7a-11a). The federal questions, although preserved, have never been addressed.

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REASONS FOR GRANTING THE PETITION

I. NORTH CAROLINA'S APPORTIONMENT OF GAINS THAT ARE NOT CONNECTED WITH THAT STATE VIOLATES *ASARCO, WOOLWORTH*, AND *ALLIED-SIGNAL*

A. North Carolina's Violation of *ASARCO, Woolworth*, and *Allied-Signal* is an Important Question

Certiorari should be granted pursuant to Supreme Court of the United States Rule 10(c) because the North Carolina courts have refused to decide important federal questions. The questions are important because the sale of

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claim for refund because the State was on notice that Petitioner asserted that it owed tax on $22,268,964 of income as opposed to the much larger extraterritorial sum of $58,647,057.

Second, after the June 1995 decision of the Augmented Board, Petitioner filed another claim for refund and the Secretary of the Department held a hearing on that claim for a refund. Any way the facts are parsed, the State was on notice within 30 days of payment of the tax that Petitioner thought that it paid too much in tax and wanted the overpayment returned.

extraterritorial businesses by multistate companies is common and frequently involves large amounts of money.

The decision of the North Carolina Court of Appeals and the dismissal of the petition by the North Carolina Supreme Court below in *Central Telephone II* in conjunction with the North Carolina court decisions in *Central Telephone I* have allowed the Secretary to tax extraterritorial income – income that has no connection to North Carolina. Taxation of extraterritorial income is prohibited by the Due Process and Commerce Clauses of the United States Constitution.

At every step of this case, in *Central Telephone I* and in *Central Telephone II*, Petitioner raised and argued that North Carolina's taxation of the gains on the sales of the Iowa and Minnesota companies violates the Due Process and Commerce Clauses. At each and every step, the North Carolina courts refused to address Petitioner's argument on the merits.

B. North Carolina Violated *ASARCO, Woolworth, Allied-Signal* and the Due Process and Commerce Clauses by Apportioning Gains from Iowa and Minnesota Companies that have No Connection to North Carolina

ASARCO involved Idaho's unsuccessful attempt to tax capital gains from the sales of companies that were not located in Idaho and had no connection to Idaho and to tax dividends and interest received from companies that had no connection to Idaho. This Court held in *ASARCO* that the capital gains, and the income and dividends, which had no connection to Idaho could not be apportioned by that state. *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 328-29 (1982).

The *ASARCO* Court focused its analysis on the apportionment of dividends but determined that interest, dividends, and gains should be treated in the same manner. *Id.* at 330. The *ASARCO* Court described the limits of taxation of income by states:

> As a general principle, a State may not tax value earned outside its borders. The broad inquiry in a case such as this, therefore, is "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return."

Id. at 315 (citations omitted). The Due Process Clause requires "'a "minimal connection" between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise.'" *Id.* at 316 (citations omitted). If a state apportions income from a multistate business, Due Process is satisfied "'so long as the intrastate and extrastate activities formed part of *a single unitary business*.'" *Id.* (citations omitted).

The unitary business principle requires "'functional integration, centralization of management, and economies of scale.'" *Id.* at 317 (citation omitted). This Court explained that "'not . . . *all* dividend income received by corporations operating in interstate commerce is necessarily taxable in each State where that corporation does business. Where the business activities of the dividend payor have *nothing to do* with the activities of the recipient in the taxing State, *due process considerations might well preclude apportionability, because there would be no underlying unitary business.'" Id.* at 317-18 (citation omitted).

Idaho argued that the unitary business principle should be defined by corporate purpose, *i.e.*, that gains, dividends, and interest should be apportionable if they contribute to a taxpayer's trade or business. This Court rejected Idaho's argument and said that Idaho's

> definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. When less ambitious interpretations are employed, the result is simply arbitrary.

Id. at 326. It continued: "We cannot accept, consistently with recognized due process standards, a definition of 'unitary business' that would permit nondomiciliary States to apportion and tax dividends '[w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State. . . .'" *Id.* at 327 (citation omitted).

This Court continued its exposition of the unitary business principle in *F.W. Woolworth Co. v. Taxation & Revenue Department of New Mexico*, 458 U.S. 354 (1982). *Woolworth* involved New Mexico's unsuccessful attempt to tax a portion of dividends that F.W. Woolworth received from companies that have no connection to New Mexico.

This Court rejected New Mexico's argument that the dividends were apportionable by New Mexico. New Mexico contended that the businesses were unitary because Woolworth controlled its subsidiaries, they were allegedly interdependent and the dividends were placed in Woolworth's general operating account. This Court recapitulated its analysis in *ASARCO* and affirmed the unitary business principle of functional integration, centralization of management, and economies of scale.

The *Woolworth* Court held that New Mexico used a different legal standard than the unitary business standard and committed error that "would trivialize [the] due process limitation by holding it satisfied if the income in question 'adds to the riches of the corporation.'" *Id.* at 363 (citation omitted). This Court continued in *Woolworth* that income from whatever source always is a business advantage to a corporation. However: "Our cases demand more." *Id.*

Ten years after *ASARCO* and *Woolworth*, New Jersey unsuccessfully attempted, in *Allied-Signal, Inc. v. Director, Division of Taxation,* 504 U.S. 768 (1992) to reverse *ASARCO* and *Woolworth*, eliminate the unitary business principle (functional integration, centralization of management, and economies of scale), and apportion a gain that had no connection to New Jersey. This Court rejected New Jersey's attempt and reaffirmed *ASARCO* and *Woolworth*.

Regarding a state's ability to tax extraterritorial income, this Court stated in *Allied-Signal*:

> Among the limitations the Constitution sets on the power of a single State to tax the multistate income of a nondomiciliary corporation are

> these: there must be "a 'minimal connection' between the interstate activities and the taxing State," and there must be a rational relation between the income attributed to the taxing State and the intrastate value of the corporate business. Under our precedents, a State need not attempt to isolate the intrastate income-producing activities from the rest of the business; it may tax an apportioned sum of the corporation's multistate business if the business is unitary. *A State may not tax a nondomiciliary corporation's income, however, if it is "derive[d] from 'unrelated business activity' which constitutes a 'discrete business enterprise.'"*

504 U.S. at 772-73 (citations omitted, emphasis added). This Court continued:

> The principle that a State may not tax value earned outside its borders rests on the fundamental requirement of both the Due Process and Commerce Clauses that there be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." The reason the Commerce Clause includes this limit is self-evident: In a Union of 50 States, to permit each State to tax activities outside its borders would have drastic consequences for the national economy, as business could be subjected to severe multiple taxation. But the Due Process Clause also underlies our decisions in this area. . . . [T]here must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax. . . . [W]e permit States to tax a corporation on an apportionable share of the multistate business carried on in part in the taxing State. That is the unitary business principle. . . . [However, the companies]

> need not be engaged in the same unitary business as a prerequisite to apportionment in all cases. . . . What is required instead is that the capital transaction serve an operational rather than an investment function.

Id. at 777-78, 787 (citations omitted). It is irrelevant whether the companies at issue are corporations or divisions. As this Court noted in *Allied-Signal*, the test is whether the companies are each an "unrelated business activity" which constitutes a "discrete business enterprise"; not what form of legal entity businesses take. *Id.* at 780 (citations omitted).

By these passages, this Court has limited a state's right to tax a multistate company's income or gains, such as Petitioner's gains. That is, it may only do so if the business is a unitary business or if the business sought to be taxed serves an operational function of the business that is conducted in that state.

The constitutional tests for a unitary business are three objective indicators: "(1) functional integration; (2) centralization of management; and (3) economies of scale." *Id.* at 781 (citations omitted). The question whether a business serves an operational rather than investment function can be answered by asking whether the business is used like an investment or like working capital. *Id.* at 788.

Some relationship between businesses is permitted that will not allow a state to tax all the extraterritorial income of the business. As this Court recognized in *Allied-Signal*, if some relationship is not allowed, then the unitary and the operational tests would not be needed. *Id.* at 789. This Court rejected the theory argued by New Jersey in *Allied-Signal* that any amount of business conducted in that state, no matter how small or unprofitable, will subject the entire business to taxation in that state. *Id.* at 784.

As this Court told North Carolina once before: North Carolina may not attribute income to North Carolina that is "out of all appropriate proportion to the business transacted . . . in that state." *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135-36 (1931).

Petitioner demonstrated at the hearing before the Secretary of the Department that the North Carolina, Iowa, and Minnesota local telephone companies were not unitary under the foregoing three objective indicators (functional integration, centralization of management, and economies of scale) and that the Iowa and Minnesota companies were not used by the North Carolina company like working capital. Petitioner demonstrated that there were no flows of value between the Iowa and Minnesota local telephone companies and the North Carolina local telephone company. Petitioner also demonstrated that North Carolina had apportioned income to North Carolina that is out of all appropriate proportion to the business transacted by Petitioner in that state.

The "unitary" question asks whether the businesses were run as a unit, that is, whether they were integrated. There was no integration between the in-state and out-of-state local telephone companies. Rather, each company operated in separate geographic regions, with separate management, separate customer bases, and subject to separate regulatory agencies. Also, there were no inter-company transfers of goods or services of any kind among the companies.

The Iowa and Minnesota companies were independent of the North Carolina company; each company maintained its own separate books and records and had separate officers; none of the North Carolina company's operating or administrative personnel contributed to the operating revenue derived from telephone services performed in Iowa or Minnesota; the North Carolina company did not manage the accounts, assets or plants of the Iowa or Minnesota Companies; and the North Carolina management was not involved in the management of the Iowa or Minnesota companies.

Petitioner's North Carolina company had only North Carolina customers and was subject to the regulations of the North Carolina Utilities Commission. The Iowa and Minnesota ~~companies had~~ only Iowa and Minnesota customers, respectively, and were subject to the utility regulatory bodies in Iowa and Minnesota, respectively. No local telephone company, North Carolina, Iowa or Minnesota, provided local telephone service or conducted any telephone business outside the state in which it was located.

Each of the local telephone companies had its own offices and handled its own regulatory affairs, advertising, marketing, purchasing, acquisitions, and human resources. Each transaction that was performed for each company by headquarters was performed for a fee pursuant to service agreements at arm's-length prices. In *Allied-Signal*, the companies (Bendix and ASARCO) ran their businesses separately, had separate plants and offices, each provided their own legal, contracting, tax, finance, and insurance services. All sales of goods or services between Bendix and ASARCO, "'were at arms length prices.'" *Allied-Signal*, 504 U.S. at 775 (citation omitted).

Petitioner did not use the Iowa and Minnesota companies as a company would use working capital. In *Allied-Signal*, 504 U.S. at 787-88, this Court explained:

> Hence, for example, a State may include within apportionable income of a nondomiciliary corporation the interest earned on short-term deposits in a bank located in another State if that income forms part of the working capital of the corporation's unitary business, notwithstanding the absence of a unitary relationship between the corporation and the bank.

Petitioner's relationship with the Iowa and Minnesota local telephone companies did not constitute a short-term investment of working capital. The *Allied-Signal* companies were run separately and the companies in Petitioner's case were run separately. No group of companies (not the Bendix and ASARCO companies and not the North Carolina company and the Iowa and Minnesota companies) was used by the others like working capital.

The companies in *Allied-Signal* were independent. The companies in Petitioner's case were independent. Professor Hellerstein, a noted scholar and writer on state and local taxation, testified at the hearing that Petitioner's case is a "clone" of *Allied-Signal*. (Hellerstein Testimony at 160). However, in Petitioner's case, no court has ever reviewed the merits of the important federal questions of taxation of extraterritorial gains.

C. Petitioner is Entitled to Review by This Court because the Due Process and Commerce Clauses have been Violated

As required under United States Supreme Court Rule 14(1)(g)(i) and as indicated in the foregoing Statement in this Petition, Petitioner has demonstrated that it raised the federal questions at every level. The decisions below are incorrect.

Under the protections guaranteed by the Due Process and Commerce Clauses and as this Court memorialized those guarantees in *ASARCO*, *Woolworth*, and *Allied-Signal*, North Carolina cannot tax the gains from the sales of the Iowa and Minnesota companies. No court reviewed the merits of Petitioner's case in light of the aforementioned Constitutional standards. It is respectfully requested that this Court review the merits of Petitioner's case.

II. NORTH CAROLINA'S DENIAL OF PETITIONER'S DUE PROCESS RIGHTS VIOLATES *JONES V. FLOWERS*

A. North Carolina's Taking of Property Without Reviewing the Merits is an Important Question

Certiorari should be granted pursuant to United States Supreme Court Rule 10(c) because the North Carolina courts have refused to decide important federal questions. This Court previously determined that this issue is worthy of granting certiorari in *Jones v. Flowers*, 126 S. Ct. 1708 (2006).

The decision of the North Carolina Court of Appeals and the dismissal of the petition by the North Carolina

Supreme Court in *Central Telephone II* in conjunction with the North Carolina court decisions in *Central Telephone I* have allowed North Carolina to create a procedural quagmire through which there has been no judicial review of North Carolina's taxation of extraterritorial income. North Carolina has provided no due process to Petitioner on the merits of the refund claim.

B. This Court Requires Due Process in Tax Matters

This Court explained that "[b]ecause exaction of a tax constitutes a deprivation of property, the State must provide procedural safeguards against unlawful exactions in order to satisfy the commands of the Due Process Clause." *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36 (1990). The "root requirement" of the Due Process Clause is "'that an individual be given an opportunity for a hearing before he is deprived of any significant property interest.'" *Id.* at 37 (citation omitted). This Court made those points in its discussion of the issue in *McKesson*, *i.e.*, the remedy for unlawful exactions after judicial review has been had. Those points are equally applicable here, where there has been *no* judicial review of the merits of Petitioner's case.

A hearing without meaningful judicial review results in a hearing held for the sake of holding a hearing. Such a hearing is a farce of due process. Here, in Petitioner's case, there has been no judicial review of the merits. At every step, North Carolina has argued that there must be no judicial review of the merits and there has never been judicial review of the merits.

In *Jones v. Flowers*, 126 S. Ct. 1708 (2006), this Court held that Mr. Jones was entitled to due process on the merits of his case. The state was not permitted to avoid the merits of the case and conclude that matter without affording due process to the taxpayer.

In *Jones*, the taxpayer (Mr. Jones) owned a home in Little Rock, Arkansas. The bank that held his mortgage collected from him an amount sufficient to satisfy the property taxes on his home and then remitted those taxes until the mortgage was satisfied, at which point the bank no longer paid the property taxes. Following the satisfaction of the mortgage, three years of property taxes accrued unpaid.

Tax sale proceedings regarding the back taxes on the home were instituted. The state avoided the merits of the case and claimed that Mr. Jones had received all the process that he was due. As a result, Mr. Jones was denied the right to argue the merits of his case. This Court disagreed with the state and required that due process be provided to Mr. Jones – that his case be heard on the merits.

C. Petitioner is Entitled to Review by This Court because Petitioner's Property has been Taken, it has been Denied Due Process, and No Court has ever Reviewed the Merits of Petitioner's Claim

There has been no judicial review of the merits of Petitioner's claim and no review of important federal questions. Petitioner is due more process than it received. At every turn of review, the state has avoided the merits of the case and the North Carolina courts have towed the state's line. This case has not protected the sanctity of Petitioner's property. Due process has not been satisfied. It is respectfully requested that this Court review the merits of Petitioner's case.

◆

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

PAUL H. FRANKEL
Counsel of Record
CRAIG B. FIELDS
MITCHELL A. NEWMARK
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Counsel for Petitioner

Dated: September 22, 2006

APPENDIX A

No. 695P05 TENTH DISTRICT

SUPREME COURT OF NORTH CAROLINA

****

(Telephone Co. v Tolson)

CENTRAL TELEPHONE COMPANY

v

E. NORRIS TOLSON, SECRETARY OF REVENUE, STATE OF NORTH CAROLINA AND HIS SUCCESSORS

From NC Court of Appeals
(COA04-1224)
From Wake
(02CVS8864)

****

ORDER

Upon consideration of the notice of appeal from the North Carolina Court of Appeals, filed by the Petitioner on the 19th day of December 2005 in this matter pursuant to G.S. 7A-30, and the motion to dismiss the appeal for lack of substantial constitutional question filed by the Respondent, the following order was entered and is hereby certified to the North Carolina Court of Appeals: the motion to dismiss the appeal is

> **"Allowed by order of the Court in conference, this the 29th day of June 2006.**
>
> **s/ Timmons-Goodson, J.**
> **For the Court"**

Upon consideration of the petition filed on the 19th day of December 2005 by Petitioner in this matter for discretionary review of the decision of the North Carolina Court of Appeals pursuant to G.S. 7A-31, the following order was entered and is hereby certified to the North Carolina Court of Appeals:

> **"Denied by order of the Court in conference, this the 29th day of June 2006.**
>
> **s/ Timmons-Goodson, J.**
> **For the Court"**

WITNESS my hand and the seal of the Supreme Court of North Carolina, this the 30th day of June 2006.

/s/ Christie S. Cameron
Christie Speir Cameron
Clerk, Supreme Court of
North Carolina

Copy to: [SEAL]
North Carolina Court of Appeals
Mr. Ralph A. White, Appellate Reporter (By E-Mail)
Mr. Jasper L. Cummings, Jr., Attorney at Law, For Central Telephone Company
Ms. Kay Linn Miller Hobart, Special Deputy Attorney General, For E. Norris Tolson (by E-Mail)
West Publishing Company (By E-mail)
Lexis-Nexis (By E-mail)
LOIS Law (By E-mail)

APPENDIX B

NO. COA04-1224

NORTH CAROLINA COURT OF APPEALS

Filed: 15 November 2005

CENTRAL TELEPHONE COMPANY

Petitioner,

v.

Wake County
No. 02 CVS 8864

E. NORRIS TOLSON, SECRETARY
OF REVENUE, STATE OF NORTH
CAROLINA AND HIS SUCCESSORS,

Respondent.

Appeal by petitioner from an order entered 3 June 2004 by Judge Stafford G. Bullock in Wake County Superior Court. Heard in the Court of Appeals 10 May 2005.

Alston & Bird LLP, by Paul H. Frankel (pro hac vice) and Morrison & Foerster LLP, by Jasper L. Cummings, Jr., for petitioner-appellant.

Attorney General Roy A. Cooper, III, by Special Deputy Attorney General Kay Linn Miller Hobart, for respondents-appellees.

JACKSON, Judge.

Central Telephone Company ("petitioner") appeals from an order of the Wake County Superior Court entered 3 June 2004 affirming the Tax Review Board's ("the Tax Board") dismissal of petitioner's petition for administrative review of the Secretary of Revenue's ("the Secretary") denial of petitioner's refund claim. The facts giving rise to this appeal are undisputed. Petitioner, during the relevant period, was a Delaware Corporation with its principal place of business in Chicago, Illinois and was authorized to do business in North Carolina. Petitioner's business included providing telecommunication services in North Carolina, Iowa, Minnesota and Nevada. In 1991 petitioner sold its operating divisions in Iowa and Minnesota resulting in a realized gain to petitioner of $170,331,652.00.

Because petitioner believed that the gain from this sale of its operating divisions in Iowa and Minnesota would result in disproportionate and improper North Carolina state income tax under North Carolina's standard apportionment formula, petitioner filed a petition with the Augmented Tax Review Board ("Augmented Board") pursuant to North Carolina General Statutes, section 105-130.4(t). In this petition, petitioner requested permission to file its North Carolina return using the separate accounting method rather than the statutory apportionment formula to reflect more accurately its North Carolina taxable income. No decision on the claim had been made by 19 September 1992, the date petitioner's return was due after being granted an extension of time to file, and petitioner filed its claim using the statutory apportionment formula and paid the resulting tax liability.

The Augmented Board subsequently denied petitioner's request on 16 June 1995, thus requiring the use of the statutory apportionment formula to calculate petitioner's 1991 North Carolina taxes. Petitioner filed an amended 1991 North Carolina corporate income tax return on 17 July 1995 using a bifurcated apportionment method to calculate its tax liability. Contemporaneously with its amended return, petitioner filed a claim for a refund with the Secretary, pursuant to North Carolina General Statutes, section 105-266.1, in excess of four million dollars.

An administrative hearing was held regarding the refund claim. Petitioner raised three issues at the hearing: (1) whether petitioner was authorized to use an alternate formula or apportionment method in making its 1991 North Carolina income tax return; (2) whether the income from the sale of petitioner's Iowa and Minnesota operating divisions was business or non-business income; and (3) whether North Carolina constitutionally was precluded from taxing the gains from the sale of the Iowa and Minnesota operating divisions as they were not part of petitioner's unitary business.

On 29 December 2000, the Secretary denied petitioner's first issue on the basis that authority to grant the requested relief was not vested in the office of the Secretary. The second issue raised by petitioner also was denied on 29 December 2000 on the basis that petitioner, and not petitioner's North Carolina subsidiary, was the taxpayer and the gain from the sale of the Iowa and Minnesota operating divisions was the business income of petitioner. The Secretary took the third issue under advisement, ordering petitioner to produce certain documents relevant to the determination of that issue by 30 June 2001. On 19 November 2001, after petitioner failed to produce the documents as ordered by the Secretary, the third issue was decided against petitioner on the separate and independent bases that: (1) in the absence of evidence that the income should be excluded from petitioner's unitary business income, a constitutional issue had been raised and that the Secretary had no authority to rule on constitutional issues; (2) petitioner had failed to carry its burden of showing by clear and cogent evidence that the Iowa and Minnesota divisions were unrelated to petitioner's business activity and constituted discrete business enterprises from petitioner as a whole; and (3) petitioner's amended return, as filed, was not a lawful return and therefore the Secretary had no authority to issue a refund based upon the amended return. Additionally, the Secretary dismissed petitioner's refund claim as a sanction for its refusal to comply with the order to produce additional documents which were deemed necessary to the determination of the final issue presented by petitioner.

Petitioner timely petitioned the Tax Board for review of the Secretary's denial of its refund claim. The Tax Board dismissed petitioner's refund claim on 4 June 2002 for lack of jurisdiction and petitioner filed a petition for judicial review in Wake County Superior Court on 3 July 2002. The court affirmed the Tax Board's dismissal of the refund claim on 3 June 2004. Petitioner timely appealed to this Court.

In addition to the instant appeal, petitioner also had pursued review of the Augmented Board's denial of its petition to use a method other than the statutory apportionment formula for the calculation of its North Carolina Corporate income tax. That review ultimately resulted in an appeal before this Court: *In re the Petition of Cent. Tel. Co.,* 167 N.C. App. 14, 604 S.E.2d 680 (2004), *appeal dismissed and disc. review denied,* 359 N.C. 281, 610 S.E.2d 203 (2005) ("*Central Telephone I*"). Our opinion in *Central Telephone I,* affirming the denial of the petition to utilize an alternate apportionment formula, is instructive in the instant case, as many of the issues are similar.

Petitioner argues that the superior court committed reversible error in affirming the Tax Board's dismissal of its petition for review because: (1) the Tax Board failed to consider the merits of petitioner's argument that the 1991 gain was not apportionable; (2) the decision of the Augmented Board was not an adequate basis for dismissal of the petition as different remedies were sought in the two proceedings; (3) the effect of the dismissal was to leave petitioner without any avenue of appeal on the merits of the issue; (4) the court considered matters on review not considered by the Tax Board; and alternatively; (5) if the petition was denied on the merits, the 1991 gain was not apportionable under the Due Process and Commerce Clauses of the United States Constitution.

Petitioner first argues that the superior court committed reversible error in affirming the Tax Board's dismissal of its petition for review of the Secretary's denial of its refund claim because the Tax Board failed to consider the merits of petitioner's argument that the 1991 gain was not apportionable. The Tax Board dismissed the petition for lack of subject matter jurisdiction over the basis for the claim. Subject matter jurisdiction refers to the authority, conferred by statute or the state constitution, of a tribunal to resolve a particular type of controversy. *See Harris v. Pembaur,* 84 N.C. App. 666, 667, 353 S.E.2d 673, 675 (1987).

The basis for petitioner's refund claim is its amended 1991 income tax return that utilized a bifurcated formula for apportioning its income to North Carolina. This formula differs from the statutorily prescribed method, and the Augmented Board is vested with the exclusive power to allow the use of any method other than that statutorily provided. N.C. Gen. Stat. § 105-130.4(t)(4) (2000). As the Augmented Board had not authorized petitioner to utilize an alternate formula, the use of the bifurcated formula rendered petitioner's return unlawful. *Id.* The Tax Board did not have the authority to allow petitioner to use an alternate formula in this instance and the Tax Board was not authorized to take any action which would have made the return lawful. To grant petitioner's refund claim based on the amended return utilizing an unauthorized alternate apportionment formula would have been tantamount to authorizing the use of that formula. The Tax Board lacked subject matter jurisdiction over the matter as it had no power to do so.

When subject matter jurisdiction over a matter is lacking, it is unnecessary to reach the merits of the controversy. *See In re N.R.M.*, 165 N.C. App. 294, 301, 598 S.E.2d 147, 151 (2004). Nor would it be proper for us to reach the merits, as the lack of subject matter jurisdiction deprives a tribunal of any authority to reach a resolution of the matter in any case. *See Harris*, 84 N.C. App. at 667, 353 S.E.2d at 675. As discussed *supra*, the Tax Board lacked subject matter jurisdiction over the basis for the petition and therefore it properly was dismissed without reaching the merits of petitioner's argument. This assignment of error is overruled.

Petitioner next argues that the Augmented Board's ruling denying petitioner's request to use an alternate apportionment formula was not an adequate basis for the Tax Board's dismissal of the petition as different remedies were sought in the two proceedings. As previously discussed, the basis for petitioner's refund claim in the instant action is its amended income tax return which was completed using an alternate apportionment formula. Accordingly, although the remedies sought were different, the ultimate issue to be decided was the same – whether petitioner was authorized to use a method of apportionment other than that statutorily prescribed. The Augmented Board previously had denied petitioner's request to utilize an alternate apportionment formula to calculate its North Carolina taxable income. Because of the Augmented Board's previous denial of the use of an alternate formula, petitioner's amended return utilizing that formula was unlawful. Consequently, the ruling of the Augmented Board was controlling on the Tax Board's decision in this matter.

Further, as an administrative tribunal, the Tax Board lacked the authority or jurisdiction to make a determination regarding the constitutionality of the tax resulting from the application of North Carolina General Statutes, section 105-130.4. It is a "well-settled rule that a statute's constitutionality shall be determined by the judiciary, not an administrative board." *Meads v. North Carolina Dep't of Agric.*, 349 N.C. 656, 670, 509 S.E.2d 165, 174 (1998); *see also Coca-Cola Co. v. Coble,* 293 N.C. 565, 238 S.E.2d 780 (1977) (N.C. Gen. Stat. § 105-266.1 confers no authority upon the Secretary to refund an illegal or invalid tax because questions of constitutionality must be decided by the courts).

Clearly, the Tax Board had no subject matter jurisdiction over any of the issues brought before it by petitioner and the petition was properly dismissed. Accordingly, this assignment of error is overruled.

Petitioner's third argument that the dismissal of its petition for review effectively left petitioner without an opportunity to appeal the Commissioner's ruling on its refund claim on its merits is unpersuasive. In *Central Telephone I,* this Court addressed petitioner's similar due process claim and held that such a claim would have merit only if petitioner was completely without redress after a decision was made by the Augmented Board. 167 N.C. App. at 26-7, 604 S.E.2d at 688.

North Carolina General Statutes, section 105-267 provides an avenue for an aggrieved taxpayer to file a civil action under the superior court's original jurisdiction against the Secretary for the refund of overpaid taxes. Further, section 105-267 affords the exclusive means for challenging the levy of an unlawful tax, even on constitutional grounds. *Bailey v. State,* 330 N.C. 227, 235, 412 S.E.2d 295, 300 (1991), *cert. denied,* 504 U.S. 911, 118 L. Ed. 2d 547 (1992), *overruled in part on other grounds by Bailey v. State*, 348 N.C. 130, 167, 500 S.E.2d 54, 76 (1998). Here, petitioner had an adequate means of redress and accordingly its due process argument is without merit. Petitioner filed an action pursuant to section 105-267 which was dismissed as untimely. The issue of whether the dismissal of that action was proper is not before us. Therefore, this assignment of error is overruled.

Petitioner's next argument is that the trial court exceeded its jurisdictional limits in reviewing the Tax Board's decision on the refund claim by considering matters that the Tax Board did not. A superior court, sitting as an appellate court over an administrative body's decision, has jurisdiction to review only those issues decided by the administrative body as its jurisdiction is derivative from the original jurisdiction of the body being reviewed. *Central Telephone I,* 167 N.C. at 27, 604 S.E.2d at 688.

The Tax Board's denial of petitioner's refund claim was based on the fact that petitioner had utilized an alternate allocation method in calculating its tax liability and corresponding refund and that the Augmented Board had not authorized the use of such a method. Accordingly, the trial court's review was limited to whether the Augmented Board's decision supported dismissal of the petition. As we held in *Central Telephone I,* the appropriate method for obtaining review of a decision of the Augmented Board is by filing a civil action pursuant to North Carolina General Statutes, section 105-267. Absent such a review overturning the decision of the Augmented Board, the Tax Board lacked subject matter jurisdiction to order a refund based on factors contrary to that decision.

Contrary to petitioners assertions, the trial court did not reach the merits of petitioner's refund claim. The trial court determined that the Tax Board's dismissal of petitioner's refund claim was proper as it lacked jurisdiction over the matters brought before it. This assignment of error is overruled.

Petitioner's final assignment of error was raised in the alternative in the event that this Court found that its petition had been dismissed on its merits. As we have held that the petition properly was dismissed for lack of subject matter jurisdiction and not on its merits, it is unnecessary to reach petitioner's additional assignments of error.

Affirmed.

Judges WYNN and BRYANT concur.

APPENDIX C

NORTH CAROLINA — **IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION**

WAKE COUNTY — **02-CVS-008864**

CENTRAL TELEPHONE COMPANY,	)	
Petitioner	)	
	)	
v.	)	**ORDER**
E. NORRIS TOLSON, SECRETARY OF REVENUE, STATE OF NORTH CAROLINA AND HIS SUCCESSORS,	)	
Respondents.	)	

(Filed Jun. 3, 2004)

THIS MATTER coming on to be heard and being heard before the undersigned Judge Presiding at the 8 March 2004 civil session of Wake County superior court, upon a petition for judicial review pursuant to G.S. §§ 105-241.3 and 150B-45 by Central Telephone Company ("Petitioner"), appealing Administrative Decision No. 383 of the Tax Review Board entered 4 June 2002, dismissing Petitioner's petition for administrative review.

PETITIONER'S petition for judicial review alleges that the Board's decision is (1) in violation of constitutional provisions; (2) in excess of the statutory authority of the agency; (3) affected by error of law; (4) unsupported by substantial evidence in view of the entire record; and (5) arbitrary and capricious and an abuse of the Board's discretion.

THE COURT having reviewed the pleadings, the record, exhibits, other matters of record, and having considered the briefs filed by the parties and having heard the arguments of counsel; and having further reviewed and examined the Administrative Decision of the Tax Review Board heretofore entered and the record upon which such decision rests; and the matter having been heard and reviewed in compliance with the requirements of Article 4 of Chapter 150B of the General Statutes, the Court finds that:

Upon *de novo* review, Administrative Decision No. 383 of the Tax Review Board is: (1) not in violation of constitutional provisions; (2) not in excess of the statutory authority or jurisdiction of the agency; (3) made upon lawful procedure; and (4) not affected by error of law; and

Applying the whole record test, Administrative Decision No. 383 of the Tax Review Board is: (1) supported by substantial evidence in view of the entire record as submitted; and (2) not arbitrary, capricious or an abuse of discretion.

THE COURT further finds that the substantial rights of the Petitioner have not been prejudiced by the decision of the Tax Review Board and that Administrative Decision No. 383 of the Tax Review Board should be affirmed in its entirety.

NOW, THEREFORE, IT IS ORDERED, ADJUDGED AND DECREED that Administrative Decision No. 383 of the Tax Review Board is AFFIRMED in its entirety. Petitioner shall pay costs.

This the 3rd day of June, 2004.

/s Stafford G. Bullock
Stafford G. Bullock
Judge Presiding

APPENDIX D

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE TAX REVIEW BOARD

IN THE MATTER OF:

The Refund Claim for Corporate
Income Taxes for the year
ending December 31, 1991 by
CENTRAL TELEPHONE COMPANY

vs.

N.C. DEPARTMENT OF REVENUE

ADMINISTRATIVE DECISION
Number: 383
Docket No. 2000-5
(Issues I & II)
Docket No. 2000-5
(Issue III)

The Regular Tax Review Board (hereinafter "Regular Board") convened a hearing in the office of the State Treasurer in the City of Raleigh, Wake County, North Carolina, on Thursday, November 29, 2001, to consider the Petition of **Central Telephone Company** (hereinafter "Taxpayer"), for administrative review of the Assistant Secretary of Revenue's Final Decision, entered on December 29, 2000, that denied Taxpayer's refund claim for corporate income taxes for the year ended December 31, 1991.

Chairman Richard H. Moore, State Treasurer, presided over the hearing with Jo Anne Sanford, Chair, Utilities Commission and duly appointed member, Noel L. Allen, Attorney at Law participating.

Paul H. Frankel, and Craig B. Fields of Morrison & Foerster, LLP, and Leigh Levine, of Alston & Bird, LLP represented the Taxpayer at the hearing. Kay Miller

Hobart, Assistant Attorney General, represented the Secretary of Revenue at the hearing.

This Matter is before the Regular Board on Taxpayer's Petition for Administrative Review of the Final Decisions entered on December 29, 2000 and November 19, 2001. The Taxpayer is a corporation headquartered in Chicago, Illinois that owns and operates four local telephone service franchises through its four separate company divisions located in Iowa, Minnesota, Nevada and North Carolina. In 1991, the Taxpayer sold the two operating divisions located in Iowa and Minnesota and included the gain from the sale as business income subject to apportionment on its North Carolina Corporate Income and Franchise Tax Return filed on September 16, 1992, for the year ended December 31, 1991.

On March 23, 2001, the Taxpayer filed a Petition with the Regular Board requesting administrative review of the Final Decision entered by Michael A. Hannah, then Assistant Secretary with the Department of Revenue, on December 29, 2000. (Docket No. 2000-5 Issues I & II). In this decision, the Assistant Secretary ruled on Issues one and two, but held the record open, and ordered the Taxpayer to produce certain documents, and ruled that the third issue would be taken under advisement pending further proceedings in the matter.

On October 30, 2001, the Regular Board notified the parties of the hearing scheduled for November 29, 2001 at 9:00 a.m. to consider Taxpayer's Petition. On November 19, 2001, Eugene J. Cella, Assistant Secretary of Revenue, rendered the Final Decision concerning Issue three of Taxpayer's refund claim. Assistant Secretary Cella issued this decision even though the Taxpayer had failed to produce the documents as ordered, by Assistant Secretary Hannah in the Final Decision rendered on December 29, 2000.

On November 19, 2001, the Attorney General, on behalf of the Secretary of Revenue, filed with the Regular Board a Motion to Dismiss Taxpayer's Petition and a Motion to Consolidate and Continue the Hearing.

At the hearing, the Taxpayer, through counsel, filed a brief opposing the Secretary of Revenue's Motion to Dismiss and the Secretary of Revenue's Motion to Consolidate and Continue the Hearing. The Taxpayer also filed an Amended Petition with the Regular Board in response to the Final Decision issued by Assistant Secretary Cella on November 19, 2001. After considering arguments of counsel, the Regular Board denied the Secretary of Revenue's motion to continue the hearing.

After the hearing, the Board took the matter under advisement and instructed the parties to file post-hearing briefs regarding this matter. The record remained open pending submission of the post-hearing briefs. On January 14, 2002, the Secretary of Revenue, through counsel, filed the post-hearing brief with the Regular Board. On February 12, 2002, the Taxpayer, through counsel, filed a reply brief with the Regular Board. On March 20, 2002, the Regular Board reviewed the Petition and the Amendment to the Petition, the Final Decisions, the Briefs, the Motion to Dismiss filed by the Secretary of Revenue and the record of the proceeding before Assistant Secretary Hannah on August 16, 2000.

After reviewing the documents filed with the Regular Board in this matter, and considering the record of the proceeding before the Assistant Secretary and the arguments presented by counsel, the Regular Board finds as follows:

1. The Taxpayer, on April 13, 1993, petitioned the Augmented Tax Review Board (hereinafter "Augmented Board") for permission to employ an alternative allocation method to determine its net income for corporate income tax purposes for the year ended December 31, 1991.

2. As set forth in the Petition to the Augmented Board, the Taxpayer determined that the gain from the sale of the two divisions was business income to be apportioned under the rules and regulations promulgated under G.S. 105-130.4.

3. The Taxpayer filed a Supplement to the above-referenced Petition with the Augmented Board on May 8, 1995.

4. The Augmented Board conducted a hearing on Taxpayer's Petition and Supplement to the Petition requesting permission to employ an alternative method of allocation to determine its corporate income tax liability to North Carolina. At this hearing, the Augmented Board considered evidentiary exhibits submitted by the Taxpayer which included the Petition, the Supplement to the Petition, the 1991 Corporate Income Tax Return, and a chart demonstrating the alternatives of separate accounting and the bifurcated apportionment to the applicable statutory allocation formula.

5. The Augmented Board issued Administrative Decision No. 444 on June 16, 1995 denying Taxpayer's request to employ an alternative apportionment method (i.e. separate accounting method and/or bifurcated apportionment formula) to determine its corporate income tax liability to North Carolina for year ended December 31, 1991. (See Affidavit of Harlan E. Boyles, then State Treasurer and Chairman to the Board, dated September 7, 2000).

6. The Augmented Board ordered the Taxpayer to employ the method of allocation prescribed by the North Carolina General Statutes to determine its corporate income tax liability to North Carolina for year ended December 31, 1991.

7. On July 17, 1995, the Taxpayer filed a petition in Wake County Superior Court for judicial review of the Augmented Board's Administrative Decision No. 444 and filed an amended North Carolina Corporate Income Tax Return for 1991, with Department of Revenue, requesting a refund of $4,148,822. The Taxpayer calculated the refund amount by using the bifurcated apportionment formula.

8. Assistant Secretary Hannah conducted a hearing on August 16, 2000, to consider Taxpayer's claim of refund in the amount of $4,148,822, for tax year ended December 31, 1991. Assistant Secretary Hannah issued his Final Decision on December 29, 2000 that denied Taxpayer's refund claim based upon its request to use a bifurcated apportionment

formula, separate accounting or any other modified apportionment formula.

9. In denying Taxpayer's refund claim, Assistant Secretary Hannah ruled upon the same issues presented by the Taxpayer to the Augmented Board.

10. Assistant Secretary Cella entered his Final Decision on November 19, 2001 with regard to the third issue for resolution of Taxpayer's refund claim. This issue addressed Taxpayer's constitutional argument. A final decision was rendered even though the Taxpayer failed to comply with Assistant Secretary Hannah's order that certain documents be produced that pertain to Issue three of Taxpayer's claim for refund.

11. The Augmented Board already ruled on the issues raised by the Taxpayer in its claim for a refund before Assistant Secretary Hannah.

Based upon the foregoing findings of fact, the Regular Board makes the following conclusions of law:

1. G.S. 105-130.4(t) permits the Augmented Board to adjust the allocation or apportionment method provided for in the statute in situations where "the method of allocation or apportionment as administered by the Secretary has operated or will so operate as to subject the [Taxpayer] to taxation on a greater portion of its income than is reasonably attributable to business or earnings within this State."

2. Pursuant to G.S. 105-130.4, the relief requested by the Taxpayer in its claim for a refund is strictly within the authority of the

Augmented Board and is not within the scope of administrative review of the Regular Board.

3. The Augmented Board is the proper forum to address the issue of whether an alternative formula or other method accurately reflects the income attributable to Taxpayer's business in this State.

4. The Augmented Board has rendered a decision on Taxpayer's Petition and Supplement to the Petition that was filed pursuant to G.S. 105-130.4(t). The issues ruled upon by the Augmented Board are identical to the issues presented by the Taxpayer at the hearing before the Assistant Secretary.

5. In denying the Taxpayer's claim for a refund in the amount of $4,148,822, the Assistant Secretary properly ruled that the Secretary of Revenue does not have authority to permit the Taxpayer to use any apportionment formula other than the one required by G.S. 105-130.4(n). The Assistant Secretary also ruled that the Secretary of Revenue does not have authority to modify the apportionment factor as requested by Taxpayer or permit the Taxpayer to use separate accounting.

6. The gain from the sale of the two divisions was business income to be apportioned under the rules and regulations promulgated under G.S. 105-130.4 and the Taxpayer made such a determination when it petitioned the Augmented Board for statutory relief.

7. The Regular Board lacks jurisdiction to consider the arguments presented by the Taxpayer in this matter. Original jurisdiction is within the exclusive province of the Augmented Board.

8. The Regular Board, which is an administrative body, does not have authority or jurisdiction to rule upon the constitutionality of a statute. *Great American Insurance Company v. Gold, 254 N.C. 168 (1961).* Thus, Taxpayer's constitutional claim is not an issue that the Regular Board is empowered to determine.

9. The Secretary of Revenue's motion to dismiss Taxpayer's Petition should be granted because this matter is not properly before the Regular Board.

IT IS THEREFORE ORDERED, ADJUGED AND DECREED that this matter be and is hereby **Dismissed**.

Made and entered into the 4th day of June 2002.

TAX REVIEW BOARD

[LOGO]

Signature Richard Moore
Richard H. Moore, Chairman
State Treasurer

Signature Jo Anne Sanford
Jo Anne Sanford, Member
Chair, Utilities Commission

Signature Noel L. Allen
Noel L. Allen, Appointed

APPENDIX E

STATE OF NORTH CAROLINA	**BEFORE THE SECRETARY**
COUNTY OF WAKE	

IN THE MATTER OF:)
)
The Refund Claim for Corporate)
Income Taxes for the year)
ending December 31, 1991 by) **FINAL DECISION**
) Docket No. 2000-5
CENTRAL TELEPHONE)
COMPANY)
)
v.)
)
N.C. DEPARTMENT)
OF REVENUE)

An Administrative Hearing was conducted before Michael A. Hannah, Assistant Secretary of Revenue, in the city of Raleigh on August 16, 2000 regarding a denial of a claim for refund of corporate income tax for tax year ended December 31, 1991 filed by Central Telephone Company (hereafter "Central Telephone" or "Taxpayer"). Central Telephone Company was represented by Paul H. Frankel and Craig B. Fields, Attorneys with Morrison & Foerster, LLP and Leigh M. Levine, Attorney with Alston & Bird, LLP. The Corporate, Excise and Insurance Tax Division (hereafter "Division" or "Department") was represented by William M. Daniel, Director, Lennie Collins, Assistant Director, Bobby L. Weaver, Jr., Administration Officer, and Kay Linn Miller Hobart, Esq., Assistant Attorney General. At the hearing, Mr. Hannah requested the parties to submit additional briefs after the hearing in support of their positions.

ISSUES

The issues to be decided in this matter are as follows:

I. Whether Taxpayer is permitted to use an alternative formula or apportionment method in making a report or return of its income to this State other than the applicable apportionment formula provided by statute or by order in writing of the Tax Review Board?

II. Whether the income from the sale of Taxpayer's internal operating divisions constitutes business or nonbusiness income?

III. Whether North Carolina is constitutionally precluded from taxing the gain because the Minnesota and Iowa operating divisions were not part of the Taxpayer's unitary business?

EVIDENCE

The following items were introduced by the parties at or subsequent to the hearing as exhibits and made part of the record:

Submitted by the Department:

D-1 Taxpayer's North Carolina Franchise and Corporate Income Tax Return for the 1991 Tax Year.

D-2 Taxpayer's Amended North Carolina Franchise and Corporate Income Tax Return for the 1991 Tax Year.

D-3 Index From Tax Review Board Record From Administrative Decision No. 444. (Record from the Tax Review Board Submitted with Exhibit # D-40)

D-4 Copy of Taxpayer's 1991 Alternative Apportionment Methodologies Submitted at the Augmented Tax Review Board Hearing.

D-5	Letter dated April 3, 1992 from Patricia Klemz, Accounting Staff Manager for Centel Corporation, to Mr. Bart McClean, Executive Secretary of the Tax Review Board and Petition for Review.
D-6	Letter dated April 7, 1992 from Patricia Klemz, Accounting Staff Manager for Centel Corporation, to the Corporation Income and Franchise Tax Division of the North Carolina Department of Revenue.
D-7	Letter dated April 15, 1992 from C.B. (Bart) McLean, Jr., Executive Secretary of the Tax Review Board, to Ms. Patricia Klemz, Accounting Staff Manager for Centel Corporation.
D-8	Letter dated December 28, 1993 from Patricia Klemz, Accounting Staff Manager for Centel Corporation, to Mr. C.B. McLean, Jr., Executive Secretary of the Tax Review Board.
D-9	Letter dated October 17, 1994 from Janet L. Shires, Executive Secretary of the Tax Review Board, to Mr. Terry Fredrick with the Sprint Corporation.
D-10	Letter dated October 26, 1994 from Mark Beshears with the Sprint Corporation to Janet L. Shires, Executive Secretary of the Tax Review Board.
D-11	Letter dated October 28, 1994 from Janet L. Shires, Executive Secretary of the Tax Review Board, to Mr. Mark Beshears with the Sprint Corporation.
D-12	Letter dated April 18, 1995 from Janet L. Shires, Executive Secretary of the Tax Review Board, to Mr. Mark Beshears with the Sprint Corporation
D-13	Letter dated May 8, 1995 from Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC, to Janet L. Shires, Executive Secretary of the Tax Review Board.

D-14 Letter dated June 16, 1995 from Janet L. Shires, Executive Secretary of the Tax Review Board, to Mr. Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC.

D-15 Letter dated July 17, 1995 from Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC, to the Honorable Janice H. Faulkner, Secretary of the North Carolina Department of Revenue.

D-16 Letter dated July 17, 1995 from Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC, to the Honorable Janice H. Faulkner, Secretary of the North Carolina Department of Revenue.

D-17 Letter dated July 17, 1995 from Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC, to the Honorable Janice H. Faulkner, Secretary of the North Carolina Department of Revenue.

D-18 Letter dated July 18, 1995 from Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PPLC [sic], to Janet L. Shires, Executive Secretary of the Tax Review Board.

D-19 Letter dated July 19, 1995 from Janet L. Shires, Executive Secretary of the Tax Review Board to Mr. Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC.

D-20 Letter dated August 16, 1995 from Janet L. Shires, Executive Secretary of the Tax Review Board to Mr. Shawn D. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC.

D-21 Letter dated August 24, 1995 from Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PPLC [sic], to Janet L. Shires, Executive Secretary of the Tax Review Board.

D-22 Letter dated August 28, 1995 from Janet L. Shires, Executive Secretary of the Tax Review Board to Mr. Shawn D. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC.

D-23 Letter dated July 5, 1996 from Kay Linn Miller Hobart, Assistant Attorney General, to Charles Mercer, attorney with Johnson, Mercer, Hearn & Vinegar, PLLC.

D-24 Memorandum dated February 27, 1997 from Charles H. Mercer, Jr., Esq. And Shawn D. Mercer, Esq. to Jack L. Harper, Director of Corporate, Excise and Insurance Tax Division, and Kay Linn Miller Hobart, Assistant Attorney General.

D-25 Letter dated April 14, 1998 from Charles H. Mercer, Jr. attorney with Johnson, Mercer, Hearn & Vinegar, PLLC to Jack Harper, Director of Corporate, Excise and Insurance Tax, and Kay Linn Miller Hobart, Esq., Assistant Attorney General.

D-26 Letter dated April 15, 1998 from Jack Harper, Director of Corporate, Excise and Insurance Tax to Charles H. Mercer, Jr. attorney with Johnson, Mercer, Hearn & Vinegar, PLLC.

D-27 Letter dated July 9, 1999 from Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP to Michael A. Hannah, Assistant Secretary of Revenue; Jack Harper, Director of Corporate, Excise and Insurance Tax, and Kay Linn Miller Hobart, Esq., Assistant Attorney General.

D-28 Letter dated July 20, 1999 from Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP to Jack Harper, Director of Corporate, Excise and Insurance Tax.

D-29	Letter dated August 3, 1999 from Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP to Jack Harper, Director of Corporate, Excise and Insurance Tax.
D-30	Letter dated August 16, 1999 from Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP to Jack Harper, Director of Corporate, Excise and Insurance Tax.
D-31	Letter dated September 27, 1999 from Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP to Jack Harper, Director of Corporate, Excise and Insurance Tax.
D-32	Letter dated September 30, 1999 from Kay Linn Miller Hobart, Esq., Assistant Attorney General to Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP.
D-33	Letter dated November 23, 1999 from Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP to Michael A. Hannah, Assistant Secretary of Revenue.
D-34	Letter dated November 30, 1999 from Michael A. Hannah, Assistant Secretary of Revenue to Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP.
D-35	Letter dated December 14, 1999 from Jack Harper, Director of Corporate, Excise and Insurance Tax to Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP.
D-36	Letter dated December 14, 1999 from Jack Harper, Director of Corporate, Excise and Insurance Tax to Michael A. Hannah, Assistant Secretary of Revenue.

D-37 Letter dated December 16, 1999 from Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP to Michael A. Hannah, Assistant Secretary of Revenue.

D-38 Letter dated December 28, 1999 from Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP to Jack Harper, Director of Corporate, Excise and Insurance Tax.

D-39 Letter dated March 24, 2000 from Michael A. Hannah, Assistant Secretary of Revenue to Jasper L. Cummings, Jr., attorney with Alston & Bird, LLP.

D-40 North Carolina Department of Revenue Pre-Hearing Brief with Exhibits #'s 1 through 9 submitted by the Division to Michael A. Hannah, Assistant Secretary of Revenue on May 22, 2000.

Exhibit # 1 – Record from Tax Review Board Index

Exhibit # 2 – Letter dated July 17, 1995 from Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC, to the Honorable Janice H. Faulkner, Secretary of the North Carolina Department of Revenue.

Exhibit # 3 – Letter dated July 17, 1995 from Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC, to the Honorable Janice H. Faulkner, Secretary of the North Carolina Department of Revenue.

Exhibit # 4 – Letter dated July 17, 1995 from Charles H. Mercer, Jr., attorney with Johnson, Mercer, Hearn and Vinegar, PLLC, to the Honorable Janice H. Faulkner, Secretary of the North Carolina Department of Revenue.

Exhibit # 5 – Taxpayer's North Carolina Franchise and Corporate Income Tax Return for the 1991 Tax Year.

Exhibit # 6 – Schedule submitted by Taxpayer to Augmented Tax Review Board Showing Taxpayer's 1991 North Carolina Apportionment Alternatives.

Exhibit # 7 – Augmented Tax Review Board Administrative Decision No. 444.

Exhibit # 8 – Taxpayer's Amended North Carolina Franchise and Corporate Income Tax Return for the 1991 Tax Year.

Exhibit # 9 – Letter dated July 5, 1996 from Kay Linn Miller Hobart, Assistant Attorney General, to Charles Mercer, attorney with Johnson, Mercer, Hearn & Vinegar, PLLC.

D-41 Taxpayer's Pre-Hearing Brief submitted by Craig B. Fields, attorney with Morrison & Foerster, LLP to Michael A. Hannah, Assistant Secretary of Revenue on June 19, 2000.

D-42 North Carolina Department of Revenue's Motion to Dismiss the Administrative Tax Hearing Dated July 20, 2000.

D-43 Assistant Secretary of Revenue's Ruling on the Motion to Dismiss the Administrative Tax Hearing Dated July 21, 2000.

D-44 Letter dated August 2, 2000 from Michael A. Hannah, Assistant Secretary of Revenue, to Leigh Levine, attorney with Alston & Bird, LLP.

D-45 North Carolina Department of Revenue Hearing Brief submitted by the Corporate, Excise and Insurance Tax Division to Michael A. Hannah, Assistant Secretary of Revenue on [text missing in original].

D-46 Motion in Limine filed by the Division to Michael A. Hannah, Assistant Secretary of Revenue on August 16, 2000 regarding the Testimony of Professor Richard D. Pomp.

D-47 Motion in Limine filed by the Division to Michael A. Hannah, Assistant Secretary of Revenue on August 16, 2000 regarding the Testimony of Professor Walter Hellerstein.

D-48 Letter dated September 15, 2000 from Michael A. Hannah, Assistant Secretary of Revenue to Craig B. Fields, attorney with Morrison & Foerster, LLP.

D-49 Letter Dated September 25, 2000 from Kay Linn Miller Hobart to Michael A. Hannah, Assistant Secretary of Revenue.

D-50 Letter dated September 31, 2000 from Michael A. Hannah, Assistant Secretary of Revenue to Craig B. Fields, attorney with Morrison & Foerster, LLP.

D-51 Letter dated November 27, 2000 from Michael A. Hannah, Assistant Secretary of Revenue to Craig B. Fields, attorney with Morrison & Foerster, LLP.

D-52 Response to Central Telephone Company's Motion for a Ruling submitted by Kay Linn Miller Hobart to Michael A. Hannah, Assistant Secretary of Revenue on November 30, 2000.

Exhibit # 1 – Affidavit of Harlan E. Boyles dated September 7, 2000.

Exhibit # 2 – Document and Information Request submitted by the Department in Response to Central Telephone Company's Motion for a Ruling.

D-53 North Carolina Department of Revenue Post-Hearing Brief submitted by the Corporate, Excise and Insurance Tax Division to Michael A. Hannah, Assistant Secretary of Revenue on November 30, 2000.

Submitted by the Taxpayer:

T-1 Report entitled "Discussion and Analysis: Central Telephone Company 1991 North Carolina State Income Tax" prepared by Karen L. Warner, CPA Deloitte & Touche LLP.

T-2 Report entitled "Expert Report of Walter Hellerstein" prepared by Professor Walter Hellerstein for Morrison & Foerster, LLP, Counsel to Central Telephone Company in connection with the Petition of Central Telephone Company concerning the allocation formula for corporate income tax purposes for the year ending December 31, 1991.

T-3 Report entitled "Expert Opinion of Professor Richard D. Pomp" prepared by Professor Richard D. Pomp.

T-4 Report entitled "Treatment of Gain on Sale of Iowa and Minnesota Divisions" prepared by Richard William Genetelli, CPA, The Genetelli Consulting Group, dated August 11, 2000.

T-5 Schedule of Taxpayer's Federal Depreciation Recapture prepared by Karen Warner, CPA, Deloitte & Touche, LLP.

T-6 Response by Karen L. Warner, CPA, Deloitte & Touche, LLP, to the North Carolina Department of Revenue's Questions Dated October 27, 2000.

T-7 Taxpayer's Opening Hearing Brief submitted by Craig B. Fields of Morrison & Foerster, LLP to Michael A. Hannah, Assistant Secretary of Revenue on October 31, 2000.

T-8 Taxpayer's "Motion for a Ruling That the Evidence Presented and Support a Decision for the Taxpayer" submitted by Craig B. Fields of Morrison & Foerster, LLP to Michael A. Hannah, Assistant Secretary of Revenue on October 31, 2000.

T-9 Taxpayer's Reply Brief submitted by Craig B. Fields of Morrison & Foerster, LLP to Michael A. Hannah, Assistant Secretary of Revenue on December 8, 2000.

T-10 Taxpayer's "Reply on Motion for a Ruling That the Evidence Presented and Support a Decision for the Taxpayer" submitted by Craig B. Fields of Morrison & Foerster, LLP to Michael A. Hannah, Assistant Secretary of Revenue on December 8, 2000.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary makes the following findings of fact:

1. Central Telephone Company, a Delaware corporation, was authorized to begin doing business in North Carolina on or about January 28, 1971.

2. In 1991, Central Telephone's principal place of business was in Chicago, Illinois.

3. Taxpayer is in the business of providing telecommunication services.

4. Prior to 1991, Taxpayer provided local telephone services in North Carolina, Iowa, Nevada and Minnesota.

5. Each local telephone company in each state was operated as an internal division of Central Telephone Company.

6. The assets of each division were acquired for use in the Taxpayer's regular business operations.

7. The assets of each division were utilized, controlled and managed as an integral part of Taxpayer's regular business operations.

8. Taxpayer is a 95.5% owned subsidiary of Centel Corporation ("Centel") located at the same physical address as Taxpayer.

9. The headquarters division of Taxpayer performed many corporate functions for the operating divisions, including the following services: a) revenue accounting and billing staff support; b) regulatory accounting; c) ad valorem tax compliance, including preparation of reports and filing of returns with governmental agencies; d) property accounting services; e) payroll processing staff support; f) payroll, materials and accounts payable systems support; g) advertising administration; h) intercompany data network operations; i) general accounting services, including maintenance of general books and operating reports and financial statements, preparation and filing of reports with governmental agencies, systems and procedures services and budget support services; j) external relations services, including public relations and carrier relations; k) executive direction and support; l) general purpose computer systems and information management services; m) legal services; n) human resources staff support; o) cost separation and access tariff services; p) access management services; q) revenue accounting services; r) centralized message investigation services; s) centralized cash processing services; t) message processing services; u) carrier access billing services; v) end user billing and collection services; w) centralized contract negotiation and administration services, including monitoring conformance to negotiated vendor contracts; and x) miscellaneous general

services supporting Taxpayer's activities, including local personnel, copy center and printing.

10. Taxpayer maintains its records in accordance with the standard classification of accounts prescribed by the Federal Communications Commission (FCC).

11. Central Telephone has annually filed a North Carolina corporate franchise and income tax return since 1971.

12. Taxpayer sold the internal operating divisions providing service to Iowa and Minnesota in 1991.

13. The Iowa and Minnesota divisions were operated as part of Taxpayer's regular business operations until the moment of disposition.

14. At no time in its filing history in this State did the Taxpayer seek separate accounting based on the distinct activities of the divisions. Except for the period from 1970 to 1977 where taxpayer utilized a separate accounting methodology without statutory authority or permission from the augmented Tax Review Board, Taxpayer filed its returns with this state based on statutory apportionment of its total income, including the operating revenues of all divisions in the apportionment formula.

15. During all years of operation, the four internal operating divisions produced apportionable business income to Taxpayer.

16. During all years of operation, the assets of the divisions incurred expenses, including, among others, depreciation, insurance and taxes, affecting the amount of net income apportionable to this state.

17. During all years of operation, the expenses associated with all four divisions were classified as business expenses on Taxpayer's return.

18. For federal income tax purposes, the sale of the two divisions resulted in a capital gain of $48,599,294 and ordinary income of $120,497,279, representing depreciation recapture.

19. On September 16, 1992, the Taxpayer filed its North Carolina Corporate Income Tax Return for the calendar year 1991, after having applied for an extension of time for filing the return on March 13, 1992.

20. Taxpayer's original 1991 tax return was filed using North Carolina's statutory method of allocating income to North Carolina pursuant to G.S. 105-130.4(n).

21. Taxpayer's original 1991 North Carolina Corporate Income Tax Return reported business income subject to apportionment of $194,067,031 with an apportionment factor of 30.22%.

22. Taxpayer classified the income, both ordinary income and capital gain, from the sale of the assets of the two divisions as apportionable business income on its original return, which it signed under penalties of perjury.

23. As a telephone company, Taxpayer apportions its business income using a single gross operating revenue factor as provided by G.S. 105-130.4(n).

24. The original return reported business income apportioned to North Carolina in the amount of $58,647,057. Taxpayer's 1991 tax liability was $4,646,872.

25. Central Telephone Company filed a petition requesting separating accounting method of allocation for calendar year 1991 with the North Carolina Augmented Tax Review Board on April 3, 1992, pursuant to G.S. 105-130.4(t).

26. Central Telephone's petition requesting separate accounting method of allocation was based upon Central Telephone's position that the statutory apportionment method of allocating taxes subjected the Taxpayer to income taxation on a greater portion of its income than is reasonably attributable to its business in North Carolina as a result of gains from the sale of two divisions located in Iowa and Minnesota.

27. Central Telephone's Petition was received and acknowledged by letter dated April 15, 1992, to Central Telephone from Bart McLean, Executive Secretary to the Tax Review Board.

28. By letter dated October 26, 1994, Taxpayer requested a continuance of the hearing date before the Augmented Tax Review Board originally scheduled for November 1994.

29. The requested continuance was granted in a letter dated October 28, 1995 from Janet L. Shires to Taxpayer.

30. By letter dated April 18, 1995 this matter was scheduled for hearing before the Augmented Tax Review Board.

31. Taxpayer Filed a supplement to its original petition on May 8, 1995.

32. A hearing was held on May 9, 1995 before the augmented Tax Review Board (consisting of the three members of the regular Tax Review Board and the Secretary of Revenue).

33. Taxpayer submitted, at the hearing on its petition for separate accounting, a document comparing three alternative filing methodologies: a) as filed, b) separate accounting, and c) bifurcated apportionment. The petition states "[t]his gain [from the sale of the two

divisions] is considered business income to be apportioned. . . . Therefore, absent a granting of relief, the income cannot be allocated out of North Carolina, but must be apportioned under G.S. 105-130.4."

34. On June 16, 1995, after consideration of the evidence, contentions and arguments, the augmented Board concluded that Taxpayer failed to overcome the presumption established in G.S. 105-130.4(t)(4) and ordered by Administrative Decision No. 444 that Taxpayer employ the method of apportionment prescribed by the North Carolina General Statutes, which is the formula set out in G.S. 105-130.4(n).

35. On July 17, 1995, Taxpayer filed an amended North Carolina Corporate Income Tax Return for the tax year 1991, using the alternative bifurcated apportionment formula presented to and rejected by the augmented Board, seeking a refund of $4,148,822.

36. By letter of July 17, 1995, taxpayer demanded a refund of this amount pursuant to G.S. 105-266.1.

37. Also, by separate letter dated July 17, 1995, taxpayer demanded a refund of the same amount under G.S. 105-267.

38. The amended return filed by Taxpayer used the alternative bifurcated apportionment formula submitted to and rejected by the augmented Tax Review Board.

39. On its amended return, Taxpayer divided its total business income of $194,067,031 into "telephone operating income" of $23,735,379 and "division sale income" of $170,331,652 on the amended return.

40. Taxpayer classified both categories, "telephone operating income" and "division sale income," as "business income" on its amended return.

41. On its amended return, Taxpayer applied the gross operating revenue factor of 30.22%, as reflected on its original return, to the "telephone operating income," producing a figure of $7,172,832.

42. Taxpayer did not apply the gross operating revenue factor of 30.22% to the "division sale income" on its amended return. Instead, it employed a self-created three-factor formula of zero percent, consisting of property, payroll and sales, which it applied to the "division sale income."

43. The amended return states that "[s]ince no property, payroll or sales tied to the sales of the divisions were located in North Carolina, the appropriate North Carolina apportionment factor for the gain on the sale of the divisions is 0%."

44. Taxpayer's bifurcated formula apportioned none of the income from the sale of its two operating divisions to North Carolina.

45. Taxpayer also filed a petition for judicial review of the Board's decision on July 17, 1995.

46. The Secretary of Revenue filed a motion to dismiss taxpayer's petition for judicial review on August 21, 1995.

47. On September 19, 1995, taxpayer filed a motion for a confidentiality order. The parties also filed a joint motion to extend the time to file the record from the Tax Review Board until taxpayer's motion for confidentiality was heard. These motions have not been heard, and the record before the augmented Board has not been filed with the court.

48. By letter of July 6, 1996, the Department denied Taxpayer's request for a refund under G.S. 105-267 as untimely; the Department also denied Taxpayer's request for a refund under G.S. 105-266.1.

49. The Department also made a motion to dismiss the administrative tax hearing with the Assistant Secretary of Revenue. This procedural issue was addressed in pre-hearing briefs filed by both parties, and a motion to dismiss was filed with the Assistant Secretary of Revenue on July 20, 2000.

50. On July 21, 2000, the Assistant Secretary of Revenue ruled that Taxpayer may obtain an administrative tax hearing under G.S. 105-266.1.

51. An Administrative Tax Hearing before the Secretary of Revenue was conducted by the hearings' officer on August 16, 2000 in the Revenue Building on 501 North Wilmington Street.

52. Taxpayer has not produced any evidence or other documentation to support its claim raised at the hearing that the gain from the sale of its business assets is nonbusiness income allocable to states other than North Carolina.

CONCLUSIONS OF LAW

Based on the foregoing findings of fact, the Assistant Secretary makes the following conclusions of law:

1. The Taxpayer is subject to corporate income taxation in this State pursuant to G.S. 105-130 *et seq.*

2. G.S. 105-130.3 imposes a tax upon the State net income of every C corporation doing business in this State.

3. Taxpayer is a C corporation.

4. Taxpayer obtained a Certificate of Authority to do business as a corporation in North Carolina from the Office of the Secretary of State on January 28, 1971.

5. "State net income" means the taxpayer's federal taxable income as determined under the Code, adjusted as provided in G.S. 105-130.5 and, in the case of a corporation that has income from business activity that is taxable both within and without this State, allocated and apportioned to this State as provided in G.S. 105-130.4.

6. Taxpayer is a multi-state corporation pursuant to G.S. 105-130.4(b).

7. Taxpayer is a "public utility" under G.S. 105-130.4(a)(6).

8. G.S. 105-130.4(a)(6) defines "public utility," in pertinent part, as "any corporation that is subject to control of one of more of the following entities: the North Carolina Utilities Commission, the Federal Communications Commission . . . that owns or operates for public use any plant, equipment, property, franchise, or license for the transmission of communications. . . . "

9. As a telephone company, Taxpayer must apportion all its business income using the gross operating revenue factor as determined under G.S. 105-130.4(a)(n).

10. G.S. 105-130.4(a)(n) stipulates that: "All business income of a telephone company shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is gross operating revenue from local service in this State plus gross operating revenue from toll services performed wholly within this State plus the proportion of revenue from interstate toll services attributable to this State as shown by the records of the company plus the gross operating revenue in North Carolina from other service less the uncollectible revenue in this State, and the denominator of which is the total gross operating revenue from all business done by the company everywhere less total uncollectible revenue. . . . "

11. The income from the sale of the Minnesota and Iowa operating divisions is business income pursuant to G.S. 105-130.4 and the Department's rule, North Carolina Administrative Rule 17 NCAC 5C .0703.

12. G.S. 105-130.4(a)(1) defines "Business income" as: "income arising from transactions and activity in the regular course of the corporation's trade or business and includes income from tangible and intangible property if the acquisition, management, and/or disposition of the property constitute integral parts of the corporation's regular trade or business operations."

13. The statutory definition of business income contains two prongs – a "transactional" prong and a "functional" prong.

14. If either the functional or the transactional test is met, the income in question is properly classified as business income.

15. Under the functional test, if the income-producing property constitutes an integral part of the taxpayer's trade or business, the income constitutes business income.

16. The fact that a transaction is an isolated or extraordinary transaction is irrelevant under the functional test.

17. The acquisition of the property in question, the assets associated with the two internal operating divisions which Taxpayer sold, constituted an integral part of Taxpayer's trade or business operations.

18. The management of the property in question, the assets associated with the two internal operating divisions which Taxpayer sold, constituted an integral part of Taxpayer's trade or business operations.

19. The disposition of the property in question, the assets associated with the two internal operating divisions which Taxpayer sold, constituted an integral part of Taxpayer's trade or business operations.

20. If the assets were used in Taxpayer's regular business prior to disposition to produce apportionable business income, the functional prong of the business income definition has been met.

21. Business assets cannot become nonbusiness assets without a definite conversion to nonbusiness use.

22. To constitute nonbusiness use, the property must be utilized for the production of nonbusiness income for a period of at least three years prior to the disposition.

23. Any gain or loss from the disposition of assets must retain the classification established prior to the dispositive transaction.

24. The disposition of assets which have been used in the regular business of Taxpayer, have been depreciated and incurred expenses and have affected the amount and percentage of business income apportionable to the state in prior years generates apportionable business income.

25. The gain from the sale of the Minnesota and Iowa divisions satisfies the functional prong and therefore constitutes business income under N.C.G.S. § 105-130.4(a)(1).

26. North Carolina Administrative Rule 17 NCAC 5C .0703 was promulgated by the Secretary of Revenue under authority of G.S. 105-262 and 105-264 to interpret G.S. 105-130.4.

27. Administrative Rule 17 NCAC 5C .0703 is *prima facie* correct.

28. Administrative Rule 17 NCAC 5C .0703(2) states, in pertinent part, that "A gain or loss from the sale, exchange or other disposition of real or personal property constitutes business income if the property while owned by the taxpayer was used to produce business income."

29. The gain from the sale of the Minnesota and Iowa divisions was properly classified by Taxpayer and the Department as apportionable business income under N.C.G.S. § 105-130.4(a)(1) and the Department's rule.

30. Taxpayer's gain from the sale of the Minnesota and Iowa operating divisions is not "operating revenue" and is, therefore, excluded from the apportionment factor pursuant to G.S. 105-130.4(n).

31. The statutory formula does not permit inclusion of the gain from the sale of the divisions in either the numerator or denominator of the formula.

32. The Secretary is without authority to issue a refund to taxpayer based upon inclusion of the gain grossed up by a factor of four in the denominator of the apportionment formula.

33. The Secretary is without authority to issue a refund to taxpayer based upon separate accounting.

34. The Secretary is without authority to issue a refund to taxpayer based on a bifurcated apportionment formula.

35. The amended return filed by taxpayer is not a lawful return.

36. The Secretary lacks authority to issue a refund based upon an unlawful return.

37. A finding that the inclusion of the gain from the sale of the operating divisions in the pre-apportionment

base taxes income "out of all appropriate proportion" to Taxpayer's activities in the state or "leads to a grossly distorted result" requires a ruling by the Secretary that the statutory formula operates in an unconstitutional manner.

38. A finding that the bifurcated apportionment formula employed by Taxpayer is necessary to avoid the taxation of activities outside North Carolina requires a ruling or declaration by the Secretary that the statutory formula in G.S. 105-130.4(n) operates in an unconstitutional manner.

39. To the extent Taxpayer's contention that receipts from the sale of the Iowa and Minnesota divisions grossed up by a factor of four should be included in the denominator of the apportionment formula alleges an issue of unconstitutional distortion, requires a ruling or declaration by the Secretary that the statutory formula in G.S. § 105-130.4(n) operates in an unconstitutional manner.

40. The Secretary has no authority under G.S. 105-266.1 to order the refund of an invalid or illegal tax, since questions of constitutionality are for the courts.

41. G.S. 105-266.1 does not provide an exception to the general rule that voluntary payments of unconstitutional tax are not refundable.

42. G.S. 105-258 states, in relevant part that: "The Secretary of Revenue, for the purpose of . . . determining the liability of any person for any tax shall have the power to examine . . . any books, papers, records, or other data which may be relevant or material to such inquiry . . . "

43. In accordance with the provisions of G.S. 105-241.1, the Secretary of Revenue must, after conducting a

hearing, make a decision based on the best information available.

44. The denial of the refund requested on the amended return was proper under the laws and the facts.

DECISION

The Taxpayer is a corporation headquartered in Chicago, Illinois that owns and operates four local telephone service franchises through its four separate company divisions located in Iowa, Minnesota, Nevada and North Carolina. In 1991, the Taxpayer sold the two operating divisions located in Iowa and Minnesota and included the gain from the sale as business income subject to apportionment on its North Carolina Corporate Income and Franchise Tax Return for that year which was filed on September 16, 1992. On April 13, 1992, the Taxpayer had filed a petition for separate accounting method of allocation with the Tax Review Board. A hearing on that petition was held on May 9, 1995, and the Board denied the Taxpayer's request on June 16, 1995, in its Administrative Decision No. 444.

On July 17, 1995, the Taxpayer filed (1) a petition seeking judicial review of Administrative Decision No. 444, (2) an amended North Carolina Corporate Income Tax Return for 1991 seeking a refund of $4,148,822 that was calculated by using the bifurcated apportionment formula originally sought and later rejected in its petition to the Tax Review Board, (3) a letter to the Secretary of Revenue demanding a refund of this amount pursuant to N.C.G.S. 105-266.1 and (4) a second letter to the Secretary of Revenue also demanding a refund under N.C.G.S. 105-267.

The Department responded by (1) filing a motion with the court to dismiss the Taxpayer's petition for judicial review on August 21, 1995, (2) denying the Taxpayer's request for a refund under N.C.G.S. 105-267 as untimely on July 6, 1996, (3) denying the Taxpayer's request for a refund under N.C.G.S. 105-266.1 based upon the facts of the case on July 6, 1996 and (4) filing a motion on July 20, 2000, with the Assistant Secretary of Revenue contending that the Taxpayer was not entitled to an administrative tax hearing because it may not simultaneously seek a refund under both N.C.G.S. 105-266.1 and 105-267. The Assistant Secretary ruled on July 21, 2000, that the Taxpayer could obtain an administrative tax hearing regarding its refund request under N.C.G.S. 105-266.1 and the hearing was held on August 16, 2000.

There are two issues presented in this case. The first issue is whether the Taxpayer is entitled to use some apportionment formula other than the one required by N.C.G.S. 105-130.4 to apportion that gain. The second issue is whether the gain from the sale of the Iowa and Minnesota Divisions should be excluded from apportionable income in North Carolina.

The Taxpayer makes the primary argument that it should be entitled to use a bifurcated apportionment formula whereby "telephone operating income" would be subject to apportionment by the gross operating revenue factor and the gain from the sale of the divisions would be subject to apportionment by the standard three-factor formula. The Taxpayer also argues that the gain from the sale of the two divisions should be excluded from the North Carolina apportionable tax base in reliance upon two different theories. First, the Taxpayer argues that the gain on the sale of the divisions is nonbusiness income.

Second, it contends that there is no unitary or operational connection between the gain and the Taxpayer's activities in North Carolina.

1. IS THE TAXPAYER ENTITLED TO USE A BIFURCATED APPORTIONMENT FORMULA TO APPORTION ITS INCOME?

N.C.G.S. 105-130.4(n) specifically sets forth the apportionment method to be applied to all of the business income of the Taxpayer, a telephone company. The statute requires that the business income base be multiplied by a gross operating income revenue factor. In its amended North Carolina Corporate Income and Franchise Return for 1991, the Taxpayer improperly employed the use of an alternative allocation method other than the formula specifically prescribed by the statute and other than the formula required by the order of the augmented Tax Review Board in Administrative Decision No. 444. N.C.G.S. 105-130.4(t)(1) provides the legal means for a corporation to obtain relief from a purportedly unreasonable apportionment formula that results in a tax that is disproportionately high in relation to the corporation's earnings in North Carolina. This procedure was correctly followed by the Taxpayer until such time as an undesirable result was obtained from the Augmented Tax Review Board. When its amended tax returns were filed, the Taxpayer blatantly ignored the Board's order and utilized the very apportionment formula that had been previously rejected.

The Taxpayer argues that taxes can only be properly imposed by this State upon income of a multistate corporation that is "earned within the State of North Carolina in its interstate business, and reasonably attributable to its interstate business done or performed within the borders of this State." *Gulf Oil Corp. v. Clayton*, 267 N.C.15, 21, 147 S.E.2d 522, 527 (1966). It then makes three arguments in support of its assertion that the use of the statutorily required single factor formula is improper in this case. First, the Taxpayer contends that including the gain from the sale of the divisions in the apportionable tax base and apportioning such gain by the operating revenue factor does not reflect a reasonable sense, of how the income was generated. *Container Corp. of Am. v. Franchise Tax Board*, 463 U.S. 159, 169 (1983). The Taxpayer argues that the gain from the sale of the divisions is a "non-operational gain" that is "wholly unrelated to the single-factor operating income formula used by North Carolina to apportion such gain . . . " (Taxpayer's Opening Brief at 26). Taxpayer insists that the "gross operating revenue factor as applied to operating and non-operating income of Central Telephone has resulted in an amount of net taxable income apportioned to North Carolina which is simply not fairly or reasonably related to Central Telephone's activities in North Carolina" (Taxpayer's Exhibit T-1, D & T Report, at 3).

The Taxpayer's second argument against the use of the single factor apportionment formula is that the tax imposed is out of all proportion to its activities in North Carolina. It then goes on to cite four separate reasons why this statement is true. First, the Taxpayer argues that the single-factor operating income formula, by including the gain from the sale of the divisions in the apportionable tax base, draws "income into North Carolina that has no connection with the State, thus taxing income that is 'out of all appropriate proportion' to the Taxpayer's activities in this state." *Hans Rees' Sons v. North Carolina ex rel.*

Maxwell,, 283 U.S. 123, 135 (1931). Secondly, the Taxpayer insists that "the apportionment formula is even more offensive than, the formula at issue in Hans Rees'" because the operating revenue factor has no relationship to the generation of the gain from the sale of the divisions. (Taxpayer's Opening Brief at 31).

Thirdly, the Taxpayer asserts that the apportionment formula attributes income to North Carolina that is "far in excess of Central Telephone's separate accounting income attributable to the North Carolina Division's activities." (Id.) Finally, the Taxpayer contends that because the gain from the sale of the divisions is classified as non-operating income under the Uniform System of Accounts, a method of separate accounting methodology required by both the North Carolina Utilities Commission and the Federal Communication [sic] for determining utility rates, the gain should not be considered in the apportionment base. The Taxpayer states that the inclusion of the gain in the Taxpayer's operating income results in a gross operating margin in excess of fifty-six percent, nearly twice the industry combined rate for 1991, and a rate that would clearly not be permitted by regulators. (Id., at 34).

The Taxpayer's third and final argument against the propriety of the single factor apportionment formula is that it generates a grossly distorted result. *Norfolk & Western Ry. v. Missouri State Tax Commission,* 390 U.S. 317, 326 (1968). The Taxpayer supports this argument by noting that a comparison of its potential tax liability using a separate accounting method and excluding the gain from the sale of the divisions to the liability resulting from an inclusion of the gain in the tax base and apportioning the gain using the single-factor operating revenue formula increases the Taxpayer's tax liability by 2.5 times. This statistically significant increase in tax, the Taxpayer concludes, means that the apportionment formula must have had a distortive and excessive result.

The Taxpayer also asserts two alternative theories as justification for its refund request. First, if it is determined that the gain from the sale of the two divisions is includible in the apportionable tax base, then the single-factor operating revenue formula should be replaced with a formula that more closely reflects how the gain was generated. Or, at the very least, the apportionment formula must include in the denominator the receipts from the sale of the Iowa and Minnesota Divisions grossed up by a factor of four. This would permit the apportionment of the gain from the sale of the two divisions to be based upon factors that reflect how the gain was generated. (Taxpayer's Opening Brief at 36). The second alternative theory presented by the Taxpayer is that it should be permitted to utilize a separate accounting method to "ensure that extraterritorial values are not taxed. . . . (Id. at 37).

N.C.G.S. 105-130.4(t)(1) augments the Tax Review Board by the addition of the Secretary of Revenue for purposes of considering a taxpayer's request for a modification to the statutorily required apportionment formula. An agreement with any of the Taxpayer's arguments noted above would require acceptance of the premise that the Secretary of Revenue can authorize the use of some modified apportionment formula other than the one required by N.C.G.S. 105-130.4(n). Such a premise is clearly unreasonable since it would require a conclusion that the Legislature would first designate the Secretary of Revenue as a member of the Augmented Tax Review Board to participate in the determination of a corporate taxpayer's request to use some apportionment formula other than the one required by statute and then permit her to change, unilaterally and at her sole discretion, the decision of the very board of which she was a member.

This is just not logical. While the Taxpayer has presented some arguments worth considering regarding the issue of whether it should be permitted to use a modified apportionment formula or separate accounting to account for the gain from the sale of the Iowa and Minnesota divisions, the Tax Review Board is the proper forum for that process, not an administrative tax hearing. Moreover, some of the issues raised by the Taxpayer involve constitutional claims of defenses, or would require a ruling that the statute is being applied in and [sic] unconstitutional manner. The Secretary of Revenue does not have to [sic] the authority to do so.

I must therefore rule that the Secretary of Revenue does not have the authority to permit the Taxpayer to use any apportionment formula other than the one required by N.C.G.S. 105-130.4(n) to apportion the gain from the sale of the Iowa and Minnesota divisions on its North Carolina Corporate Income and Franchise Return for 1991. Furthermore, I rule that the Secretary of Revenue does not have the authority to either modify the apportionment factor as requested by the Taxpayer or to permit the Taxpayer to utilize a separate accounting. These issues should properly be decided, and in fact have already been decided, by the Augmented Tax Review Board as set forth in N.C.G.S. 105-130.4(t)(1).

2. IS THE GAIN FROM THE SALE OF THE IOWA AND MINNESOTA DIVISIONS BUSINESS INCOME UNDER THE TRANSACTIONAL TEST AND/OR THE FUNCTIONAL TEST?

N.C.G.S. 105-130.4(a)(1) defines business income as "income arising from transactions and activity in the regular course of the corporation's trade or business and includes income from tangible and intangible personal property if the acquisition, management, and/or disposition of the property constitute integral parts of the corporation's regular trade or business operations." In interpreting this statute, the North Carolina Supreme Court has determined that it establishes two tests for determining whether a corporation's income is business income: the transactional test and the functional test. *Polaroid Corp v. Offerman* 349 N.C. 290, 507 S.E.2d 284 (1998). The Taxpayer asserts that the gain from the sale of the Iowa and Minnesota divisions does not constitute business income under N.C.G.S. 105-130.4(a)(1) because it does not satisfy either the transactional test or the functional test cited in *Polaroid* and is therefore nonbusiness income pursuant to N.C.G.S. 105-130.4(a)(5).

A. Transactional Test

The Department has not contested the Taxpayer's assertion that the gain from the sale of the two divisions does not meet the requirements of the transactional test and so I will not rule on that issue.

B. Functional Test

The functional test set forth in N.C.G.S. 105-130.4 states that business income "includes income from tangible or intangible property if the acquisition, management, and/or disposition of the property constitutes integral parts of the corporation's regular trade or business operation." Under the functional test, once assets are determined to constitute an integral part of the taxpayer's regular trade or business operation, any income from those assets is considered business income without any limitation on how it was received. (*Polaroid* at 300). In this case, the Iowa and Minnesota divisions were decidedly integral parts of the Taxpayer's regular business operations, therefore, any income generated from those assets, including the gain from the sale of those divisions, is business income. Under the functional test, the extraordinary or non-recurring nature of the gain from the sale is irrelevant. (*Id* at 296).

The Taxpayer argues that the North Carolina Supreme Court's ruling in *Union Carbide Corp. v. Offerman* 351 N.C. 310, 526 S.E.2d 167 (2000) indicates that the two controlling elements of the functional test require an inquiry here into whether the Iowa and Minnesota divisions were essential parts of its business operations *in North Carolina*. (Taxpayer's Opening Brief at 13) (underlining added). The Taxpayer then goes on to cite many facts that it contends show there were no operational connections between the Iowa and Minnesota divisions and the North Carolina division, as well as many other facts which indicate that the North Carolina division was not involved in the sale of those other two divisions in any way. (Id at 13-17).

In further support of its contention that the functional test requires the property in question be part of a corporations business operations in North Carolina, the Taxpayer noted that the North Carolina Supreme Court stated in *Polaroid* that the North Carolina Corporate Income Tax Act is based upon the Uniform Division of Income for Tax Purposes Act ("UDITPA"). "UDITPA was designed to apportion among the states in which a mulitistate [sic] or multinational corporation does business the fair amount of net taxable business income *earned by the corporation's activities in each state. Polaroid Corp. v. Offerman,* at 304 507 S.E.2d at 294 (citing *Pledger v. Getty Oil Exploraton* [sic] *Co.,* 309 Ark. 257, 262, 831 W.W.2d 121 (1992) (emphasis added by the Taxpayer). According to the Taxpayer, the North Carolina Supreme Court's discussion of UDITPA requires a conclusion that the Legislature, by enacting the North Carolina Corporate Income Tax Act, "specifically intended that the provisions of the Act only apportion income 'earned by the corporation's activities in each state'" because that Act is based upon UDITPA. (Taxpayer's Reply Brief at 5).

Therefore, the Taxpayer reasons, when the Legislature enacted N.C.G.S. 105-130.4(a)(1) it did not intend to apportion income to this State that was not earned by a corporation's activities in North Carolina. The Taxpayer's argument continues that since that statute must be read in a manner consistent with this legislative intent, then business income should only include income derived from property that constitutes a corporation's regular business operations in North Carolina. The Taxpayer then concludes that because the gain from the sale of the Iowa and Minnesota divisions was not derived from the Taxpayer's regular business operations in North Carolina, that gain cannot properly be apportioned to this State.

This novel approach to interpreting N.C.G.S. 105-130.4(a)(1) has at least one fatal flaw. An acceptance of the Taxpayer's interpretation would in effect nullify the basic tenets underlying the apportionment theory of UDITPA and negate the very need for an apportionment formula. It appears that the Taxpayer is in essence attempting to utilize a separate accounting of those activities that can be specifically associated with an individual state. I do not interpret the quotation from *Polaroid* noted by the Taxpayer in the same way. In my estimation, the phrase "UDITPA was designed to apportion among the states in which a mulitistate [sic] or multinational corporation does business the fair amount of net taxable business income *earned by the corporation's activities in each state*" was not intended to [sic] by the North Carolina Supreme Court to limit the application of the functional test in the manner suggested by the Taxpayer. (emphasis added by the Taxpayer). Such an interpretation would quite simply be contrary to the very purpose of apportionment.

The North Carolina Supreme Court has never ruled that N.C.G.S. 105-130.4(a)(1) requires that assets disposed of must have been essential to the selling corporation's business operations in this State in order for the gain from such sale to be considered business income as contended by the Taxpayer. The proper inquiry in this case under the functional test as set forth in *Polaroid* is whether the two operating divisions disposed of were acquired and managed as integral parts of the Taxpayer's regular business. The reasoning of the North Carolina Supreme Court in *Polaroid* does not require appending the phrase "in this state" onto the language of N.C.G.S. 105-130.4(a)(1).

Furthermore, it is obvious that the gain from the sale of the Iowa and Minnesota divisions should clearly be classified as business income under Administrative Rule 17 NCAC 5C.0703. That rule states in relevant part that:

> "The gain or loss recognized on the sale of property . . . may be business or nonbusiness income depending upon the relation to the taxpayer's trade or business:
>
> . . .
>
> (2) **A gain or loss from the sale, exchange or other disposition of Real or personal property constitutes business income if the property while owned by the taxpayer was used to produce business income** . . .

(emphasis added)

This administrative rule represents the policy of the Department regarding this issue since at least 1967 and was cited with approval by the North Carolina Supreme Court in *Polaroid* as an accurate reflection of legislative intent in the of [sic] wording N.C.G.S. 105-130.4(a)(1). *See* 349 N.C. at 303, 507 S.E.2d at 294. The record clearly shows that the Taxpayer, during the years preceding the sale of the two divisions, regularly and consistently reported the income from those operations as business income on its North Carolina Corporate Franchise and Income Tax Returns and apportioned that income properly in compliance with N.C.G.S. 105-130.4. Because the two divisions were used by the Taxpayer to produce business income, there can be no doubt that the gain from the sale of the two divisions is therefore business income under Rule .0703(2).

The Taxpayer cites *Laurel Pipe Line Co. v. Pennsylvania*, 537 Pa. 205, 642 A.2d 472 (1994) in support of its position that the gain from the sale of independent and separate business divisions constitutes nonbusiness income. In that case, the Pennsylvania Supreme Court determined that a company engaged in both intrastate and interstate transportation of refined petroleum products over company owned pipelines generated nonbusiness income when it sold the interstate pipeline but retained and continued to operate the intrastate pipeline. The Taxpayer argues that the Pennsylvania court focused on the issues of the company's divestiture of an independent and separate business unit and also the cessation of one of the separate businesses as determinative in that case. Likewise, the Taxpayer continues, its "sale of the Iowa and Minnesota divisions constituted a complete cessation of Central Telephone's local telephone business in Iowa and Minnesota" and the gain should therefore be considered nonbusiness income in North Carolina. (Taxpayer's Reply Brief at 8)

While the Department accurately responds that the decision of another state court is not binding in North Carolina, it is worthwhile to note its reply with regard to *Laurel Pipe Line*. The Department cites an extremely significant factor that distinguishes that case from the Taxpayer's circumstances by correctly noting that the applicable language in the Pennsylvania statute under consideration read "acquisition, management *and* disposition" of the property, while the North Carolina statute at issue here reads "acquisition, management *and/or* disposition of the property" in determining whether it is an integral part of a corporation's regular business. In my opinion, this is a very important distinction.

In *Laurel Pipe Line* the Pennsylvania court focused on the fact that while the taxpayer continued to operate its intrastate pipeline, the sale of the taxpayer's interstate pipeline constituted a liquidation of a separate and distinct aspect of the pipeline business, namely, the interstate pipeline business. It appears that the Pennsylvania court's emphasis on the fact that the disposition of the pipeline was not an integral part of the taxpayer's regular trade or business was crucial to their determination that the gain from the sale was not business income. This focus on the disposition of the interstate pipeline, while critical given the use of the word "and" in the Pennsylvania statute as noted above, is not determinative in the Taxpayer's case here because the North Carolina statute uses the word "or."

While the disposition of a corporation's assets arguably may not occur as an integral part of a corporation's regular business, especially in a partial liquidation, the acquisition and management of the Iowa and Minnesota divisions as an integral part of the Taxpayer's regular business in this case is all that is required for the gain from their sale to be considered business income under the North Carolina statute.

Even if an interstate pipeline business can be considered separate and distinct from an intrastate pipeline business as determined by the Pennsylvania court in Laurel Pipe Line, I am not convinced that the sale of two operating divisions of a company that provide the same telecommunications services in different states would be considered separate and distinct.

Moreover, the Department also pointed out another critical distinction between Laurel Pipe Line and this case.

There, the pipeline that was sold had ceased producing business income to the taxpayer and were, in fact, idle. Here, by contrast, the two divisions produced business income up until the time of disposition. Furthermore, under Administrative Rule 5C.0703, assets that generate business income cannot produce nonbusiness income upon disposition unless they produced nonbusiness income for three years prior to being disposed of.

The Taxpayer has cited the recent decision of the North Carolina Court of Appeals in *Lenox, Inc. v. Offerman,* No. COA99-1267 (N.C. Ct. App. Dec. 5, 2000) in further support of its argument that the gain from the sale of the Iowa and Minnesota Divisions constitutes nonbusiness income. While the majority in that case did rule that the gain from the sale by a manufacturer of consumer goods of an operating division that manufactured fine jewelry was nonbusiness income, I believe that there are sufficient significant factual distinctions between the sale transactions and the operations of the taxpayer in *Lenox* and those of the Taxpayer here to distinguish the two cases. Indeed, the sale of the Taxpayer's two divisions here would very likely be considered business income under the reasoning of the majority in *Lenox.*

In *Lenox,* the majority opinion, in synthesizing the results of four cases it found relevant to its analysis, *McVean & Barlow, Inc. v. New Mexico Bureau of Revenue,* 543 P.2d 489, N.M. Ct.App.1975), *Welded Tube Co. v. Commonwealth,* 515 A.2d 988 (Pa.Commw.Ct.1986), *Texaco-Cities Service Pipeline Co. v. McGaw,* 695 N.E. 2d 481 (Ill.1998), and *Laurel Pipe Line,* stated that "whether the business liquidation results in a complete cessation of the company's involvement in that line of business is particularly relevant." (Lenox at 4) (underling [sic] added).

Thus the Lenox court found that "(c)essation ultimately justified treating the gains as nonbusiness income in *McVean & Barlow* and *Laurel Pipe Line,* whereas noncessation justified classisfication [sic] as business income in *Welded Tube* and *Texaco-Cities.*" (Id).

The liquidation of the taxpayer's jewelry division in Lenox, whereby it completely extricated itself from that particular line of business, jewelry, can be distinguished from the Taxpayer's sale here of its Iowa and Minnesota telecommunications divisions. In the Taxpayer's case it did not completely cease its involvement in the telecommunications business with the liquidation of the two divisions because it remained in that line of business in other states, including North Carolina, following the sale. In my opinion the gain from the sale of the Iowa and Minnesota divisions is business income under the court's reasoning in *Lenox* because there was no cessation of the Taxpayer's involvement in the telecommunications business.

In addition, I most respectfully disagree with the majority decision in *Lenox* and opine that the well reasoned dissent more closely follows the decision of the North Carolina Supreme Court in *Polariod* [sic] *v. Offerman.* The income that was produced by the Iowa and Minnesota divisions prior to their sale was business income and was recognized as such by the Taxpayer. Because the Legislature is presumed to always act with full knowledge of statutes, "the fact that our state statute requires *only* that the 'disposition of the property constitute integral parts of the corporation's regular trade or business operations,' and not the 'acquisition and management' as well, serves as notice that as long as the asset handled by the corporation produced income as an integral part of the corporation's regular trade or business operations, that income is business income. N.C.Gen. Stat. 105-130.4(a)(1). (*Lenox, Inc. v. Offerman,* dissenting opinion of Judge Hunter). (underlining added).

The Secretary of Revenue has a right to appeal the decision in Lenox to the North Carolina Supreme Court as a matter of law and I must therefore conclude that the issue has not been ajudicated [sic] with sufficient finality to be binding or determinative here.

Central Telephone Company is the taxpayer here, not the North Carolina division. The Taxpayer operates each of the four divisions that provided the same type of telecommunications services in each of the four states in which the divisions operated. There is no doubt that each of the four operating divisions were integral and essential parts of the telecommunications service operations provided by Taxpayer, its regular business, and they were indeed treated as such by the Taxpayer for tax accounting purposes. Even assuming, arguendo, that the disposition of the Iowa and Minnesota divisions may not have been integral to the Taxpayer's business, because those two divisions were acquired and managed as integral parts of the Taxpayer's regular business, the gain from their sale is business income as defined in N.C.G.S. 105-130.4(a)(1) under the functional test and also as clearly defined in Administrative Rule 17 NCAC 5C.0703(2).

3. IS THERE A UNITARY CONNECTION BETWEEN THE GAIN FROM THE SALE OF THE IOWA AND MINNESOTA DIVISIONS AND THE TAXPAYER'S ACTIVITIES IN NORTH CAROLINA?

In this case, the Department insists that it has not been given the opportunity to review certain documents that that [sic] it deems relevant and important to allow a proper determination of the issue of whether there is a unitary connection between the gain from the sale of those out of state divisions and North Carolina. (Departments Response to Motion p. 3) The Department asserts that it would be prejudiced by its inability to review certain documents that it claims are relevant to those two issues and requests that it be provided with those documents by the Taxpayer. (Id., at Exhibit 2). The Taxpayer responds that there is sufficient evidence in the record to determine both issues.

While the procedural requirements of the Rules of Evidence properly and necessarily provide order, fairness and uniformity to judicial proceedings, the North Carolina Legislature has seen fit to specifically exclude the application of these rules from administrative tax hearings in N.C.G.S. 105-141.1(c). This is, in my opinion, to permit the Secretary of Revenue to consider in her deliberations certain documents or other evidence that, while potentially excludable under the technical and stringent standards of the Rules of Evidence, should properly be considered by her because the information is relevant to, or probative of, the issue of the correct amount of tax due. Such an arrangement is clearly proper so that both the representatives of the Department and the taxpayer in a controversy can have an opportunity to present fully and completely the best information available to the trier of fact, unfettered by the burdensome restrictions of legal procedures and evidentiary rulings that could unnecessarily envelope both sides in a morass of civil procedure.

The determination of whether the gain from the sale of the Iowa and Minnesota divisions of the Taxpayer was unitary with its operations in North Carolina involves very complex facts and requires a very detailed inquiry into the nature of the relationships between the Taxpayer and its operating divisions over several years. In my judgment, there is presently not sufficient evidence in the record to properly and equitably make that determination under the "best information available" standard specifically required by N.C.G.S. 105-242.1. While the Taxpayer makes the argument that there is sufficient evidence in the record to reach a conclusion on that issue, I must disagree in light of the importance and complexity of the matter. In my opinion, the Secretary of Revenue has been granted broad powers to determine the types and amount of information that can be requested during the administrative tax hearing process.

The purpose of an administrative tax hearing is to permit the Secretary of Revenue, or her designee, the opportunity to review and deliberate all of the documents, facts and circumstances that can reasonably be made available so that she can make the best informed, well reasoned determination of the proper tax liability of a taxpayer. This position is supported by N.C.G.S 105-258, which states in relevant part that:

> The Secretary of Revenue, for the purpose of . . . determining the liability of any person for any tax . . . shall have the power to examine . . . any books, papers records, or other data which may be relevant or material to such inquiry . . .

Thus, it appears from the statute that the only restriction upon the types of documents that can be requested by the Secretary to make such a determination is that they must be relevant or material.

I am very cognizant of the fact that my tenure as the hearings officer will terminate at the end of 2000, which would seem at first blush to require my ruling on all of the issues presented in this case. However, a hurried, ill-considered final decision made in the interest of practical expediency and without the benefit of careful consideration and quiet reflection upon the best information available would not properly serve either the Taxpayer or the Department.

There is, in my opinion, sufficient evidence in the record to rule upon the issues of whether the Taxpayer is entitled to utilize a bifurcated apportionment formula and whether the gain from the sale of the Iowa and Minnesota divisions is business or nonbusiness income. Accordingly, I have done so earlier in this final decision. However, with regard to the issue of whether the two divisions were unitary with the Taxpayer's operations in North Carolina, I believe that some of the documents requested by the Department in its Exhibit 2 of the Response to Motion are relevant and material to the matter and should be provided to the Department for review.

The Taxpayer has, by the arguments made at the hearing and later clarified in its opening brief, presented the significant issue of whether the Iowa and Minnesota divisions are unitary with the Taxpayer's business operations in North Carolina. The evidence presented by the Taxpayer raises significant and important questions that warrant further investigation and clarification regarding that issue. It would be inappropriate to close the record now and render a final decision with those questions unanswered.

Furthermore, to deny the Department's request to obtain those documents that it deems necessary for making a proper determination of the tax liability of the Taxpayer would unfairly prejudice the Department's case. If the Department had certain documents in its possession that the Taxpayer now chose to request, I would not hesitate to require that the Department provide them and to also allow the Taxpayer reasonable time to review and respond to them. The "lateness of the hour" here is not sufficient grounds to deny the Department's request for additional documents. The Department is entitled to a copy of those documents that can be provided without creating an undue burden on the Taxpayer. The Taxpayer would not be significantly prejudiced by such a requirement to provide documents and to have the issue of unitariness determined at a later date by my successor. The interest of the Department in obtaining those documents that it considers so important to its case outweighs any inconvenience that may be suffered by the Taxpayer as a result of a requirement to provide them.

The record in this case is very complete, including not only a complete written transcript of the hearing held on August 16, 2000, that was prepared by and submitted for the record by the Taxpayer, but also an audio recording of the entire hearing, as well as supplemental briefs submitted by both sides following the hearing. These documents would permit the new hearings officer to have access to all of the information in the record and to fully and completely review it during deliberations. This review of the record could easily be supplemented by submission of additional briefs and written or oral arguments by both sides solely on the issue of unitariness without the need for the Taxpayer to incur the expenses involved with reconvening the hearing in Raleigh.

This procedure would provide both the Taxpayer and the Department with a reasonable and equitable solution that does not prejudice or unduly burden either side. If either side concludes that such an arrangement is not satisfactory, then it may request and should be granted the opportunity to convene the hearing under the new hearings officer on the issue of unitariness. In my opinion, this arrangement provides an equitable and fair solution that affords due process to the Taxpayer.

I have reviewed the document request made by the Department in Exhibit 2 to its Response to Motion, as well as the Taxpayer's objection to the document request. While some of the items requested by the Department's [sic] may arguably be redundant or overlapping, some of the documents would clearly be relevant or material to the question of the proper tax liability of the Taxpayer as required by N.C.G.S. 105-258. In my opinion, the Taxpayer's general objection to all of the documents requested is too broad and lacks sufficient detail with regard to each of the separately numbered requests to properly make a determination of relevance or materiality for each document. Accordingly, I must order that that all of the documents requested in Exhibit 2 of the Department's Response to Motion be provided by the Taxpayer to the Department no later than June 30, 2001, or by a later date if so requested by the Taxpayer and upon a proper showing of why such an extension would be necessary. In the alternative, the Taxpayer may request, and should be granted, an evidentiary hearing either in Raleigh, or through an exchange of written arguments, on the issue of whether any of the documents requested by the Department should be provided by the Taxpayer. The details of this arrangement should be determined by my successor.

Therefore, the Taxpayer's request to use a bifurcated apportionment formula or any other modified formula to apportion the gain from the sale of the two divisions is denied. The Taxpayer's request to use a separate accounting of the gain from the sale of the two divisions is denied. The Taxpayer's request for a refund of corporate income tax based on its claim that the gain from the sale of the Iowa and Minnesota divisions is nonbusiness income is denied.

The Taxpayer's request for a refund based upon its claim that there is no unitary connection between the gain from the sale of the Iowa and Minnesota divisions and its operations in North Carolina is taken under advisement pending further proceedings as stated herein.

Made and entered this 29 day of December, 2000.

Signature /s/
Michael A. Hannah
Assistant Secretary of Revenue

APPENDIX F

STATE OF NORTH CAROLINA **COUNTY OF WAKE**	**BEFORE THE SECRETARY**
IN THE MATTER OF: **The Refund Claim for Corporate Income Taxes for the year ending December 31, 1991 by** **CENTRAL TELEPHONE COMPANY** **v.** **DEPARTMENT OF REVENUE**	**FINAL DECISION** **Docket No. 2000-5** **(Issue III)**

An Administrative Hearing was conducted before Michael A. Hannah, Assistant Secretary of Revenue, in the city of Raleigh on August 16, 2000 regarding the denial of a claim for refund of corporate income tax for tax year ended December 31, 1991 filed by Central Telephone Company ("Central Telephone" or "Taxpayer"). The issues to be decided were as follows:

I. Whether Taxpayer is permitted to use an alternative formula or apportionment method in making a report or a return of its income to this State other than the applicable apportionment formula provided by statute or by order in writing of the Tax Review Board?

II. Whether the income from the sale of Taxpayer's internal operating divisions constitutes business or nonbusiness income?

III. Whether North Carolina is constitutionally precluded from taxing the income from the sale of the Minnesota and Iowa divisions because the divisions were not part of Taxpayer's unitary business?

In Final Decision Docket No. 2000-5 (Issues I and II), the Assistant Secretary held that the Secretary of Revenue does not have the authority to permit Taxpayer to: (i) use any apportionment formula other than the one required by N.C.G.S. § 105-130.4(n); (ii) modify the apportionment factor as requested by Taxpayer; or (iii) permit Taxpayer to use separate accounting. The Assistant Secretary further held that these issues should properly be decided, and, in fact, have already been decided, by the Augmented Tax Review Board pursuant to N.C.G.S. § 105-130.4(t). The Assistant Secretary then denied Taxpayer's refund claim based upon its request to use a bifurcated apportionment formula, separate accounting or any other modified apportionment formula (Issue I).

The Assistant Secretary also held that the sale of the internal operating divisions produced business income, and denied Taxpayer's refund request based upon its claim that the gain was non business income (Issue II).

Regarding the issue of whether North Carolina is constitutionally precluded from taxing a portion of the income from the sale of the Minnesota and Iowa divisions because the divisions were not part of Taxpayer's unitary business, a claim which Taxpayer raised for the first time at the administrative hearing, the Assistant Secretary stated that "[i]t would be inappropriate to close the record now and render a final decision with [certain] questions unanswered." Final Decision Docket No. 2000-5 (Issues I and II), at 30. The Assistant Secretary ordered Taxpayer to provide certain documents to the Department no later than June 30, 2001 or by a later date if requested by the Taxpayer upon a proper showing of why such extension was necessary. The Assistant Secretary then ruled that Taxpayer's request for refund based upon its claim that the Minnesota and Iowa divisions were not part of its unitary business (Issue III) was to be "taken under advisement pending further proceedings as stated herein." *Id.* at 32.

This final decision, Final Decision Docket No. 2000-5 (Issue III), addresses the third and final issue regarding Taxpayer's claim for a refund of corporate income tax for tax year ended December 31, 1991. Final Decision Docket No. 2000-5 (Issues I and II) is incorporated herein by reference.

EVIDENCE

Exhibits D-1 through D-53 and T-1 through T-10 are incorporated herein by reference. In addition, the following items are introduced as exhibits and made part of the record:

D-54	Letter from Bobby L. Weaver, Jr. to Craig B. Fields dated August 8, 2000.
D-55	Power of Attorney submitted by Paul H. Frankel, Craig B. Fields and Leigh Levine dated August 16, 2000.
D-56	Final Decision Docket No. 2000-5 (Issues I and II).
D-57	Letter from Bobby L. Weaver, Jr. to Craig B. Fields dated August 28, 2001.

FINDINGS OF FACT

Findings of Fact 1 through 52 are incorporated herein by reference. In addition, the Assistant Secretary makes the following findings of fact:

53. The headquarters division of Taxpayer performed many corporate functions for the entire company, including the Minnesota, Iowa and North Carolina divisions.

54. The headquarters division of Taxpayer managed and controlled Taxpayer's operating divisions, including the Minnesota, Iowa and North Carolina divisions.

55. The Minnesota, Iowa, and North Carolina divisions were engaged in the same line of business.

56. Taxpayer has failed to comply with the Secretary's order to produce the requested documents.

57. Taxpayer has neither requested an extension nor provided any explanation for its failure to comply with the Secretary's order.

CONCLUSIONS OF LAW

Conclusions of Law 1 though 44 are incorporated herein by reference. In addition, the Assistant Secretary makes the following conclusions of law:

45. Taxpayer's argument that the unitary business principle requires exclusion of the income from the sale of the Minnesota and Iowa divisions from its apportionable income raises a constitutional issue.

46. The Secretary has no authority to rule on constitutional issues.

47. The Secretary has no authority under N.C.G.S. § 105-266.1 to order the refund of an allegedly unconstitutional tax, since questions of constitutionality are for the courts.

48. The Secretary has no authority under N.C.G.S. § 105-266.1 to order a refund based on Taxpayer's claim that inclusion of the income from the sale of the two divisions in its apportionable income is unconstitutional.

49. N.C.G.S. § 105-267 provides the exclusive remedy for Taxpayer to seek a refund based on its constitutional claim.

50. Taxpayer has failed to comply with the mandatory provisions of N.C.G.S. § 105-267.

51. Final Decision Docket No. 2000-5 (Issues I and II) did not finally determine Taxpayer's liability for corporate income tax for its 1991 tax year.

52. The Assistant Secretary in Final Decision Docket No. 2000-5 (Issues I and II) held the record open, ordered Taxpayer to produce certain documents, and held that Issue III regarding Taxpayer's liability for corporate income tax for 1991 was to be taken under advisement pending further proceedings as stated therein.

53. Taxpayer's failure to comply with the Secretary's order and produce the documents was unjustified.

54. In order to exclude certain income from the apportionable base, the taxpayer has the distinct burden of showing by clear and cogent evidence that the income was derived from unrelated business activity which constitutes a discrete business enterprise.

55. The constitutional question is whether the Minnesota and Iowa divisions were unrelated to Central Telephone as a whole, and whether they were discrete business enterprises from that of Taxpayer as a whole.

56. Taxpayer has failed to satisfy its "distinct burden" of providing "clear and cogent evidence" that the Minnesota and Iowa divisions were unrelated to Taxpayer's business activity and constituted discrete business enterprises from that of Central Telephone as a whole.

57. The amended return filed by Taxpayer was not a lawful return.

58. The Secretary has no authority to issue a refund based upon an unlawful return.

59. The denial of the refund claim is proper under the law and the facts.

60. The Secretary has an obligation and an implied power to enforce its rules and orders.

61. Dismissal of Taxpayer's refund claim is an appropriate sanction for Taxpayer's failure to comply with a formal order of the Secretary.

62. Dismissal of Taxpayer's refund claim is proper under the law and the facts.

63. Taxpayer's liability for corporate income tax for its 1991 tax year is hereby finally determined.

DECISION

At the administrative hearing, Taxpayer advanced, for the first time, the claim that it is entitled to a refund of the corporate income tax at issue on the grounds that the United States Constitution prohibits North Carolina from including the income from the sale of the Minnesota and Iowa divisions in its apportionable base because the divisions were not part of its unitary business.

Taxpayer's argument that the unitary business principle requires exclusion of the income from its apportionable income raises a constitutional issue. *See Hunt-Wesson, Inc. v. Franchise Tax Board,* 528 U.S. 458, 461 (2000) (the income of which a state taxes a percentage is constitutionally limited to a corporation's "unitary" income); *Allied-Signal, Inc. v. Director, Div. of Taxation,* 504 U.S. 768 (1992) (the unitary business principle remains an appropriate device for ascertaining whether a state has transgressed constitutional limitations in taxing a nondomiciliary corporation).

A refund based on this theory thus requires a ruling or declaration by the Secretary that inclusion of the income in the apportionable base is unconstitutional, and this I am without authority to do. The Secretary has no authority to rule on the constitutionality of a statute or to pass on constitutional questions. *Gulf Oil Corp. v. Clayton,* 267 N.C. 15, 147 S.E.2d 522 (1966); *Great American Insurance Co. v. Gold,* 254 N.C. 168, 118 S.E.2d 792 (1961). More specifically, the Secretary has no authority under N.C.G.S. § 105-266.1 to order the refund of an invalid or illegal tax, since questions of constitutionality are for the courts. *Coca-Cola Co. v. Coble,* 293 N.C. 565, 238 S.E.2d 780 (1977). N.C.G.S. § 105-266.1 does not provide a remedy whereby unconstitutional taxes may he recovered by the taxpayer. *Coca-Cola Co. v. Coble,* 33 N.C.App. 124, 234 S.E.2d 477, *aff'd,* 293 N.C. 565, 238 S.E.2d 780 (1977).

Rather, N.C.G.S. § 105-267 is the appropriate procedure for a taxpayer who seeks to test the constitutionality of a statute or its application to him. *Gulf Oil Corp. v. Clayton,* 267 N.C. 15, 147 S.E.2d 522; *see also Coca-Cola Co. v. Coble*, 293 N.C. 565, 238 S.E.2d 780. In fact, N.C.G.S. § 105-267 is "the sole resort for a taxpayer seeking to challenge the legality of a state tax. By contrast, the immediately preceding section of the state tax code, § 266.1, provides the avenue for recovering an excessive amount paid because of a clerical or mathematical error." *Swanson v. Faulkner,* 55 F.3d 956 (4th Cir. 1995), *cert. denied,* 516 U.S. 964 (1995).

I therefore hold that the Secretary has no authority under N.C.G.S. § 105-266.1 to order a refund based on the claim that inclusion of the income from the sale of the two divisions in Taxpayer's apportionable income is unconstitutional. I further hold that N.C.G.S. § 105-267 sets forth the exclusive remedy for Taxpayer to pursue its constitutional claim. Finally, I hold that Taxpayer has failed to comply with the mandatory provisions of N.C.G.S. § 105-267. For these reasons, Taxpayer's refund claim is hereby denied.

In Final Decision Docket No. 2000-5 (Issues I and II), Taxpayer was ordered to provide certain documents and other information to evaluate the factual basis for its belated claim that the Minnesota and Iowa divisions were not part of Taxpayer's unitary business. To date, Taxpayer has failed to comply with the Secretary's order to produce the requested documents. Taxpayer has neither requested an extension nor provided any explanation for its failure to comply with the Secretary's order.

In order to exclude certain income from the apportionable base under the unitary business principle, the taxpayer always has the "distinct burden of showing by 'clear and cogent evidence' that [the state tax] results in extraterritorial values being taxed." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 175 (1983) (citations omitted; brackets in original). "Unitary income normally includes all income from a corporation's business activities, but excludes income that 'derives from unrelated business activity which constitutes a discrete business enterprise.'" *Hunt-Wesson, Inc. v. Franchise Tax Board,* 528 U.S. 458, 461 (2000) (quoting *Allied-Signal,* 504 U.S. at 773).

Thus, in order to prevail in its claim, and exclude the income from the sale of the two divisions from its apportionable base, Taxpayer bears the "distinct burden" of proving "by clear and cogent evidence" that the Minnesota and Iowa divisions were unrelated to Taxpayer's business activity and constituted discrete business enterprises from that of Central Telephone as a whole. Where Taxpayer has failed to comply with an order of the Secretary to produce documents so that all facts relevant to the claim may be considered, it cannot meet its "distinct burden" of providing "clear and cogent evidence" to support its claim. Regardless of the nature of a taxpayer's request for refund, it always bears the burden to substantiate and document its claim, including all the factual underpinnings. For this additional and independent reason, Taxpayer's refund claim is hereby denied.

The Taxpayer made no effort to comply with the Secretary's order and offered no explanation for its refusal to comply. Instead, Taxpayer simply ignored a formal order of this Court. The Secretary has an obligation and an implied power to enforce its rules and orders. Dismissal of Taxpayer's refund claim is an appropriate sanction for Taxpayer's failure to comply with an order of this tribunal. *See In re Appeal of Fayetteville Hotel Assoc.,* 117 N.C.App. 285, 288, 450 S.E.2d 568, 570 (1994) ("without implicit authority to enforce its rules by dismissal, the [Property

Tax] Commission's effectiveness as a quasi-judicial body would be fatally compromised"). Taxpayer's refund claim is hereby dismissed for failure to comply with the Secretary's order.

Finally, as the first final decision in this matter concludes, the amended return filed by Taxpayer was not a lawful return. The Secretary has no authority to issue a refund based upon an unlawful return. For this additional and independent reason, Taxpayer's refund claim is hereby denied.

Accordingly, for each of the foregoing alternative and independent reasons, Taxpayer's request for refund based upon its claim that North Carolina is constitutionally prohibited from including the income from the sale of the Minnesota and Iowa divisions in its apportionable base is denied. In addition, Taxpayer's refund claim is hereby dismissed. The record in this matter is now closed. The Secretary's decision denying Central Telephone's claim for a refund of corporate income tax for its tax year ending December 31, 1991 is now final and Central Telephone's corporate income tax liability for its 1991 tax year is hereby finally determined.

Made and entered this 19th day of November, 2001.

Signature /s/ Eugene J. Cella
Eugene J. Cella
Assistant Secretary of Revenue

APPENDIX G

No.: COA04-1224 TENTH DISTRICT

North Carolina Court of Appeals

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CENTRAL TELEPHONE COMPANY, Petitioner, V E. NORRIS TOLSON, SECRETARY OF REVENUE, STATE OF NORTH CAROLINA AND HIS SUCCESSORS, Respondents.	From Wake (02CVS8864)

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ORDER

(Filed Jul. 26, 2006)

The Motion to Dismiss the Appeal for lack of substantial constitutional question filed by the Respondnet [sic] is Allowed and Petition for Discretionary Review filed by Petitioner to review the decision of the North Carolina Court of Appeals filed on the 15th day of November 2005 was denied by order of the North Carolina Supreme Court on the 29th day of June 2006, and same has been certified to the North Carolina Court of Appeals;

IT IS THEREFORE CERTIFIED to the Clerk of Superior Court Wake County North Carolina that the North Carolina Supreme Court has allowed the Motion to Dismiss the Appeal for lack of substantial constitutional question filed by the Respondent and denied the Petition for Discretionary Review filed by the Petitioner in this cause.

WITNESS my hand and official seal this the 26th day of July 2006.

[SEAL]

/s/ John H. Connell
John H. Connell Clerk, North
Carolina Court of Appeals

/s/ Kathy Taylor
Deputy Clerk, North
Carolina Court of Appeals

Orig. to CSC
Copy to:
Mr. Jasper L. Cummings, Jr., Attorney at Law
For Central Telephone Company
Mr. Paul H. Frankel, Attorney at Law,
For Central Telephone Company
Mr. Craig B. Fields
Ms. Roberta Moseley Nero
Ms. Kay Linn Miller Hobart, Special
Deputy Attorney General,
For State N.C. Dept. of Justice

APPENDIX H

N.C. Stat. § 105-130.4. Allocation and apportionment of income for corporations.

(a) As used in this section, unless the context otherwise requires:

(1) "Business income" means income arising from transactions and activity in the regular course of the corporation's trade or business and includes income from tangible and intangible property if the acquisition, management, and/or disposition of the property constitute integral parts of the corporation's regular trade or business operations.

(2) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(3) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(4) "Excluded corporation" means any corporation engaged in business as a building or construction contractor, a securities dealer, a loan company or a corporation which receives more than fifty percent (50%) of its ordinary gross income from investments in/or dealing in intangible property.

(5) "Nonbusiness income" means all income other than business income.

(6) "Public utility" means any corporation which is subject to control of North Carolina Utilities Commission, and/or Federal Communications Commission, Interstate Commerce Commission, Federal Power Commission, and Federal Aviation Agency and which owns or operates for public

use any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, or the production, storage, transmission, sale, delivery or furnishing of electricity, water, steam, oil, oil products, or gas.

(7) "Sales" means all gross receipts of the corporation except receipts from any casual sale of property and except receipts allocated under subsections (c) through (h) of this section.

(8) "Casual sale of property" means the sale of any property which was not purchased, produced or acquired primarily for sale in the corporation's regular trade or business.

(9) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(b) A corporation having income from business activity which is taxable both within and without this State shall allocate and apportion its net income or net loss as provided in this section. For purposes of allocation and apportionment, a corporation is taxable in another state if (i) the corporation's business activity in that state subjects it to a net income tax or a tax measured by net income, or (ii) that state has jurisdiction based on the corporation's business activity in that state to subject the corporation to a tax measured by net income regardless whether that state exercises its jurisdiction. For purposes of this section, "business activity" includes any activity by a corporation that would establish a taxable nexus pursuant to 15 United States Code section 381.

(c) Rents and royalties from real or tangible personal property, gains and losses, interest, dividends less the portion deductible under G.S. 105-130.7, patent and copyright royalties and other kinds of income, to the extent that they constitute nonbusiness income, less related expenses shall be allocated as provided in subsections (d) through (h) of this section.

(d)(1) Net rents and royalties from real property located in this State are allocable to this State.

(2) Net rents and royalties from tangible personal property are allocable to this State:

a. If and to the extent that the property is utilized in this State, or

b. In their entirety if the corporation's commercial domicile is in this State and the corporation is not organized under the laws of, or is not taxable in, the state in which the property is utilized.

(3) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the income year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the income year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the corporation, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

(e)(1) Gains and losses from sales or other disposition of real property located in this State are allocable to this State.

(2) Gains and losses from sales or other disposition of tangible personal property are allocable to this State if

a. The property had a situs in this State at the time of the sale, or

b. The corporation's commercial domicile is in this State and the corporation is not taxable in the state in which the property has a situs.

(3) Gains and losses from sales or other disposition of intangible personal property are allocable to this State if the corporation's commercial domicile is in this State.

(f) Interest and net dividends are allocable to this State if the corporation's commercial domicile is in this State subject to the following limitations:

(1) Net dividends received by a corporation from another corporation in which the recipient corporation owns fifty (50%) or more per centum of the paying corporation's voting stock, shall be allocated to this State if the paying corporation is subject to income tax in this State. In such case, the net amount of such dividends received by the recipient corporation from the paying corporation is allocable to this State by use of the same percentage figure used in determining the portion of the paying corporation's dividends deductible under the provisions of G.S. 105-130.7.

(2) For purposes of this section, the net amount of dividends shall mean gross dividend income received less related expenses and less that portion

of such dividends deductible under the provisions of G.S. 105-130.7.

(g)(1) Royalties or similar income received from the use of patents, copyrights, secret processes and other similar intangible property are allocable to this State:

a. If and to the extent that the patent, copyright, secret process or other similar intangible property is utilized in this State, or

b. If and to the extent that the patent, copyright, secret process or other similar intangible property is utilized in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this State.

(2) A patent, secret process or other similar intangible property is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, processing, or other use in the state or to the extent that a patented product is produced in the state. If the basis of receipts from such intangible property does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the intangible property is utilized in the state in which the taxpayer's commercial domicile is located.

(3) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

(h) The income less related expenses from any other nonbusiness activities or investments not otherwise specified in this section is allocable to this State if the business situs of the activities or investments are located in this State.

(i) All business income of corporations other than public utilities and excluded corporations shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four. Provided, that where the sales factor does not exist, the denominator of the fraction shall be the number of existing factors and where the sales factor exists but the payroll factor or the property factor does not exist, the denominator of the fraction shall be the number of existing factors plus one.

(j)(1) The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in this State during the income year and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented and used during the income year.

(2) Property owned by the corporation is valued at its original cost. Property rented by the corporation is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the corporation less any annual rental rate received by the corporation from subrentals except that subrentals shall not be deducted when they constitute business income. Any property under construction and any property the income from which constitutes nonbusiness

income shall be excluded in the computation of the property factor.

(3) The average value of property shall be determined by averaging the values at the beginning and end of the income year, but in all cases the Secretary of Revenue may require the averaging of monthly or other periodic values during the income year if reasonably required to reflect properly the average value of the corporation's property. A corporation which ceases its operations in this State before the end of its income year because of its intention to dissolve or to relinquish its certificate of authority, or because of a merger or consolidation, or for any other reason whatsoever shall use the real estate and tangible personal property values as of the first day of the income year and the last day of its operations in this State in determining the average value of property, but the Secretary may require averaging of monthly or other periodic values during the income year if reasonably required to reflect properly the average value of the corporation's property.

(k)(1) The payroll factor is a fraction, the numerator of which is the total amount paid in this State during the income year by the corporation as compensation, and the denominator of which is the total compensation paid everywhere during the income year. All compensation paid to general executive officers and all compensation paid in connection with nonbusiness income shall be excluded in computing the payroll factor. General executive officers shall include the chairman of the board, president, vice-presidents, secretary, treasurer, comptroller, and any other officers serving in similar capacities.

(2) Compensation is paid in this State if:

a. The individual's service is performed entirely within the State; or

b. The individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or

c. Some of the service is performed in this State and (i) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in this State, or (ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

(*l*)(1) The sales factor is a fraction, the numerator of which is the total sales of the corporation in this State during the income year, and the denominator of which is the total sales of the corporation everywhere during the income year. Notwithstanding any other provision under this Division, the receipts from any casual sale of property shall be excluded from both the numerator and the denominator of the sales factor. Where a corporation is not taxable in another state on its business income but is taxable in another state only because of nonbusiness income, all sales shall be treated as having been made in this State.

(2) Sales of tangible personal property are in this State if the property is received in this State by the purchaser. In the case of delivery of goods by common carrier or by other means of transportation, including transportation by the purchaser,

the place at which the goods are ultimately received after all transportation has been completed shall be considered as the place at which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person or firm designated by a purchaser from within or without the State shall constitute delivery to the purchaser in this State.

(3) Other sales are in this State if:

a. The receipts are from real or tangible personal property located in this State; or

b. The receipts are from intangible property and are received from sources within this State; or

c. The receipts are from services and the income-producing activities are in this State.

(m) All business income of a railroad company shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the "railway operating revenue" from business done within this State and the denominator of which is the "total railway operating revenue" from all business done by the company as shown by its records kept in accordance with the standard classification of accounts prescribed by the Interstate Commerce Commission.

"Railway operating revenue" from business done within this State shall mean "railway operating revenue" from business wholly within this State, plus the equal mileage proportion within this State of each item of "railway operating revenue" received from the interstate business of the company. "Equal mileage proportion" shall mean the proportion which the distance of movement of property and passengers over lines in this State bears to the total distance of movement of property and passengers over lines of the company receiving such revenue. "Interstate business" shall mean "railway operating revenue" from the interstate transportation of persons or property into, out of, or through this State. If the Secretary of Revenue shall find, with respect to any particular company, that its accounting records are not kept so as to reflect with exact accuracy such division of revenue by State lines as to each transaction involving interstate revenue, the Secretary of Revenue may adopt such regulations, based upon averages, as will approximate with reasonable accuracy the proportion of interstate revenue actually earned upon lines in this State. Provided, that where a railroad is being operated by a partnership which is treated as a corporation for income tax purposes and pays a net income tax to this State, or if located in another state would be so treated and so pay as if located in this State, each partner's share of the net profits shall be considered as dividends paid by a corporation for purposes of this Division and shall be so treated for inclusion in gross income, deductibility, and separate allocation of dividend income.

(n) All business income of a telephone company shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is gross operating revenue from local service in this State plus gross operating revenue from toll services performed wholly within this State plus the proportion of revenue from interstate toll services attributable to this State as shown by the records of the company plus the gross operating revenue in North Carolina from other service less the uncollectible revenue in this State, and the denominator of which is the total gross operating revenue from all business done by the company everywhere less total uncollectible revenue. Provided, that where a telephone company is required to keep its records in accordance with the standard classification of accounts prescribed by the Federal Communications Commission the amounts in such accounts shall be used in computing the apportionment fraction as provided in this subsection.

(o) All business income of a motor carrier of property shall be apportioned by multiplying the income by a fraction, the numerator of which is the number of vehicle miles in this State and the denominator of which is the total number of vehicle miles of the company everywhere. The words "vehicle miles" shall mean miles traveled by vehicles owned or operated by the company hauling property for a charge or traveling on a scheduled route.

(p) All business income of a motor carrier of passengers shall be apportioned by multiplying the income by a fraction, the numerator of which is the number of vehicle miles in this State and the denominator of which is the total number of vehicle miles of the company everywhere. The words "vehicle miles" shall mean miles traveled by vehicles owned or operated by the company carrying passengers for a fare or traveling on a scheduled route.

(q) All business income of a telegraph company shall be apportioned by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.

The property factor shall be as defined in subsection (j) of this section, the payroll factor shall be as defined in subsection (k) of this section, and the sales factor shall be as defined in subsection (l) of this section.

(r) All business income of an excluded corporation and of all other public utilities shall be apportioned by multiplying the income by the sales factor as determined under subsection (l) of this section.

(s) All business income of an air or water transportation corporation shall be apportioned by a fraction, the numerator of which is the corporation's revenue ton miles in this State and the denominator of which is the corporation's revenue ton miles everywhere. The term "revenue ton mile" means one ton of passengers, freight, mail, or other cargo carried one mile. In making this computation, a passenger is considered to weigh two hundred pounds.

(t)(1) If any corporation believes that the method of allocation or apportionment as administered by the Secretary of Revenue has operated or will so operate as to subject it to taxation on a greater portion of its income than is reasonably attributable to business or earnings within the State, it shall be entitled to file with the Tax Review Board a petition setting forth the facts upon which its belief is based and its argument with respect to the application of the allocation formula. This petition shall be filed in such form and within such time as the Tax Review Board may prescribe. The Board shall grant a hearing thereon. At least three members of the Tax Review Board shall attend any hearing pursuant to such petition. In such cases, the Tax Review Board's membership shall be augmented by the addition of the Secretary of Revenue, who shall sit as a member of said Board with full power to participate in its deliberations and decisions with respect to petitions filed under the provisions of this section. An informal record containing in substance the evidence, contentions and arguments presented at the hearing shall be made. All members of the augmented Tax Review Board shall consider such evidence, contentions and arguments and the decisions thereon shall be made by a majority vote of the augmented Board.

(2) If the corporation employs in its books of account a detailed allocation of receipts and expenditures which reflects more clearly than the applicable allocation formula prescribed by this section the income attributable to the business within this State, application for permission to base the return upon the taxpayer's books of account shall be considered by the Tax Review Board. The Board shall be authorized to permit such separate accounting method in lieu of applying the applicable allocation formula if the Board deems such method proper as best reflecting the income and earnings attributable to this State.

(3) If the corporation shall show that any other method of allocation than the applicable allocation formula prescribed by this section reflects more clearly the income attributable to the business within this State, application for permission to base the return upon such other method shall be considered by the Tax Review Board. The application shall be accompanied by a statement setting forth in detail, with full explanations, the method the corporation believes will more nearly reflect its income from business within this State. If the Board shall conclude that the allocation formula prescribed by this section allocates to this State a greater portion of the net income of the corporation than is reasonably attributable to business or earnings within this State, it shall

determine the allocable net income by such other method as it shall find best calculated to assign to this State for taxation the portion of the corporation's net income reasonably attributable to its business or earnings within this State.

(4) There shall be a presumption that the appropriate allocation formula reasonably attributes to this State the portion of the corporation's income earned in this State, and the burden shall rest upon the corporation to show the contrary. The relief herein authorized shall be granted by the Board only in cases of clear, cogent and convincing proof that the petitioning corporation is entitled thereto. No corporation shall use any alternative formula or method other than the applicable allocation formula provided by statute in making a report or return of its income to this State except upon order in writing of the Board, and any return in which any alternative formula or other method, other than the applicable allocation formula prescribed by statute, is used without permission of the Board shall not be a lawful return.

When the Board determines, pursuant to the provisions of this subsection, that an alternative formula or other method more accurately reflects the income allocable to North Carolina and renders its decision with regard thereto, the corporation shall allocate its net income for future years in accordance with such determination and decision of the Board so long as the conditions constituting the basis upon which the decision was made remain unchanged or until such time as the business method of operation of the corporation changes. Provided, however, that the Secretary of Revenue may, in his discretion, with respect to any subsequent year, require the corporation to furnish information relating to its property, operations, and activities.

(5) A corporation which proposes to do business in this State may file a petition with the Board setting forth the facts upon which it contends that the applicable allocation formula will allocate a greater portion of the corporation's future income to North Carolina than will be reasonably attributable to its proposed business or contemplated earnings within the State. Upon a proper showing in accordance with the procedure described above for determinations by the Board, the Board may authorize such corporation to allocate income from its future business to North Carolina on the basis prescribed by the Board under the provisions of this section for such future years if the conditions constituting the basis upon which the Board's decision is made remain unchanged and the business operations of the corporation continue to conform to the statement of proposed methods of business operation presented by the corporation to the Board.

(6) When the Secretary of Revenue asserts liability under the formula adjustment decision of the Tax Review Board, an aggrieved corporation may pay the tax and bring a civil action for recovery under the provisions of Article 9. (1939, c. 158, s. 311; 1941, c. 50, s. 5; 1943, c. 400, s. 4; 1945, c. 752, s. 3; 1953, c. 1302, s. 4; 1955, c. 1350, s. 18; 1957, c. 1340, s. 4; 1959, c. 1259, s. 4; 1963, c. 1169, s. 2; c. 1186; 1967, c. 1110, s. 3; 1973, c. 476, s. 193; c. 1287, s. 4; 1981 (Reg. Sess. 1982), c. 1212; 1987, c. 804, s. 2; 1987 (Reg. Sess., 1988), c. 994, s. 1.)

APPENDIX I

STATE OF NORTH CAROLINA COUNTY OF WAKE	BEFORE THE TAX REVIEW BOARD
IN THE MATTER OF: The Petition of **CENTRAL TELEPHONE COMPANY** concerning the allocation formula for corporate income tax purposes for the year ended December 31, 1991.	**ADMINISTRATIVE DECISION NUMBER:** 444

On April 13, 1992, CENTRAL TELEPHONE COMPANY (hereinafter "Company") filed with the Tax Review Board its Petition concerning the allocation of the Company's net income for corporate income tax purposes for the year ended December 31, 1991 pursuant to G.S. §105-130.4(t).

The Tax Review Board (hereinafter "Board") heard this matter on May 9, 1995 in the City of Raleigh, Wake County, North Carolina in the office of the State Treasurer. Chairman Harlan E. Boyles presided over the hearing with Janice H. Faulkner, Secretary of Revenue and Jeff D. Batts, Attorney at Law participating.

Charles H. Mercer, Jr. and Shawn D. Mercer, Attorneys at Law appeared on behalf of the Company; also present on behalf of the Company were Terrence D. Frederick, State Income Tax Manager and Mark Beshears, Assistant Vice-President for State and Local Tax.

Following the meeting, the Board reviewed the Petition and supplemental documents filed in this matter and considered the arguments presented at the meeting. The Board concluded that the Company did not carry its burden of proof and failed to show that the method of allocation prescribed by statute would operate so as to allocate to North Carolina a greater portion of the Company's net income for corporate income tax purposes than was reasonably attributable to its operation in this State. The Board therefore rendered its decision and entered the following Order:

IT IS HEREBY ORDERED BY THE TAX REVIEW BOARD that the Company's Petition for authorization to use a separate accounting method for computing North Carolina taxable income for income tax purposes for the year ended December 31 1991 is **DENIED**. The Board concludes that the Company failed to overcome the presumption, established in G.S. §105-130.4(t)(4), that the statutory allocation formula reasonably attributes to this State that portion of the corporation's income earned in this State. The Company shall be required to employ the method of allocation prescribed by the North Carolina General Statutes.

Entered this the 16th day of June, 1995.

TAX REVIEW BOARD

[SEAL]

/s/ Harlan E. Boyles
Harlan E. Boyles, Chairman
State Treasurer

/s/ Janice H. Faulkner
Janice H. Faulkner
Secretary of Revenue

/s/ Jeff D. Batts
Jeff D. Batts

APPENDIX J

NORTH CAROLINA	**IN THE GENERAL COURT OF JUSTICE SUPERIOR**
WAKE COUNTY	**COURT DIVISION**
	95-CVS-6955

IN THE MATTER OF:	)	
	)	
The petition of CENTRAL TELEPHONE COMPANY concerning the allocation formula for corporate income tax purposes for the year ended December 31, 1991.	)	**ORDER**

THIS MATTER came on for hearing before the undersigned judge presiding at the 2 June 2003 civil session of Wake County superior court. The matter was heard upon respondent Secretary of Revenue's motion to dismiss pursuant to N.C. Gen. Sta. § 1A-1, Rule 12(b)(1) on the grounds that the Court lacked jurisdiction over the subject matter.

The COURT having reviewed the pleadings, the record, exhibits, other matters of record, and having considered the briefs filed by the parties and having heard the arguments of counsel, the Court concludes that it lacks jurisdiction over the subject matter. The Court therefore concludes that this action should be dismissed pursuant to N.C. Gen. §1A-1, Rule 12(b)(1).

WHEREFORE, it is hereby ORDERED that respondent's motion to dismiss pursuant to N.C. Gen. Stat. § 1A-1, Rule 12(b)(1) is GRANTED and that this action is hereby DISMISSED with prejudice.

This the 26th day of June 2003.

/s/ A. Leon Stanback
A. Leon Stanback
Superior Court Judge Presiding

APPENDIX K

NO. COA03-1313

NORTH CAROLINA COURT OF APPEALS

Filed: 16 November 2004

IN THE MATTER OF: THE PETITION OF CENTRAL TELEPHONE COMPANY CONCERNING THE ALLOCATION FORMULA FOR CORPORATE INCOME TAX PURPOSES FOR THE YEAR ENDED DECEMBER 31, 1991.	From Wake County No. 95-CVS-6955

(Filed Nov. 16, 2004)

Appeal by petitioner Central Telephone Company from order entered 26 June 2003 by Judge A. Leon Stanback in Wake County Superior Court. Heard in the Court of Appeals 16 June 2004.

Morrison & Foerster, L.L.P., by Paul H. Frankel and Craig B. Fields, (both admitted pro hac vice); and Alston & Bird, L.L.P., by Jasper L. Cummings, Jr., for Central Telephone Company petitioner appellant.

Attorney General Roy Cooper, by Assistant Attorney General Kay Linn Miller Hobart, for defendant appellee.

McCULLOUGH, Judge

Central Telephone Company ("petitioner") appeals from an order by the superior court dismissing, based on lack of subject matter jurisdiction, its petition for judicial review from a decision of the Augmented Tax Review Board ("ATRB"). *See* N.C. Gen. Stat. § 1A-1, Rule 12(b)(1)

(2003) of the North Carolina Rules of Civil Procedure. The petitioner's appeal arises from the following undisputed facts: During the tax year ending 31 December 1991, petitioner sold two of its extraterritorial telephone companies, one located in Iowa and one in Minnesota. By following the normal apportionment formula (the "apportionment formula") for corporate North Carolina telephone operators, petitioner believed the sale of these two extraterritorial telephone companies was improperly attributed as income for its business activities in North Carolina for the 1991 tax year. *See* N.C. Gen. Stat. § 105-130.4(n) (2003).[1] Specifically, petitioner contended:

> Under § 105-130.4(n), income of a telephone company is apportioned on the *basis of gross operating revenue*. Using the 12-31-91 Income Statement, the percentage of total income apportionable to North Carolina is 31.52%. Under normal apportionment calculation, this would result in an amount of income attributable to North Carolina of $59,602,186. North Carolina net income as reflected on the 12-31-91 income statement is $22,304,876. By following the normal apportionment formula, over two and one half times the recognized income would be attributable to business within North Carolina.

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[1] Apportionment formulas are designed to meet both of the following: the due process requirement that a state show a sufficient nexus between the corporate tax and the transaction within a state for which the tax is an exaction; and the proscriptions of the Commerce Clause of the Federal Constitution which permit a state to tax only that part of a corporation's net income from multistate operations which is attributable to earnings within the taxing state. *Oil Corp. v. Clayton, Comr. of Revenue,* 267 N.C. 15, 20, 147 S.E.2d 522, 526 (1966).

> The increase is directly due to the income from the sale of the Iowa and Minnesota divisions.

(Emphasis added.)

On 13 April 1992, petitioner filed a petition with the ATRB pursuant to N.C. Gen. Stat. § 105-130.4(t)(1), seeking relief from the statutory formula. The ATRB acknowledged the petition on 15 April 1992, and granted a hearing date for sometime "in the near future." Having been granted an extension for filing, petitioner filed its taxes in conformance with the apportionment formula on 16 September 1992. Petitioner made a tax payment to the Department of Revenue in the amount of $4,646,872.00.

The record shows that a hearing before the ARTB [sic] was to be set for some time between 28 December 1993 and June of 1994. Counsel for petitioner changed during this time period. The hearing date was scheduled for 9 November 1994. Centel Corporation, the parent corporation of petitioner, was then acquired by Sprint Corporation ("Sprint"), and counsel for Sprint requested the ATRB hearing be continued until "at least" January 1995. The request was granted, and on 18 April 1995, petitioner was given notice of a 9 May 1995 hearing date. After a hearing was held on this date, the ATRB rendered Administrative Decision Number 444 dated 16 June 1995, denying the use of a separate accounting method or a bifurcated apportionment formula for computing petitioner's North Carolina taxable income for the tax year of 1991. The ATRB concluded petitioner failed to overcome the presumption, as set forth in N.C. Gen. Stat. § 105-130.4(t)(4) (2003), that the statutory apportionment formula reasonably attributes to North Carolina that portion of the corporation's income earned in this State.

On 17 July 1995, petitioner filed a petition for judicial review of the ATRB decision. Petitioner based the Wake County Superior Court's jurisdiction on N.C. Gen. Stat. § 105-130.4(t)(6), N.C. Gen. Stat. § 150B-43, *et seq.* (2003), and "other applicable law." The State filed a motion to dismiss this petition pursuant to N.C. Gen. Stat. § 1A-1, Rule 12(b)(1), stating the court lacked subject matter jurisdiction for such review.

As set out in the findings of fact for the Final Decision of the Secretary of Revenue denying petitioner's corporate refund which petitioner sought using alternative apportionment calculations (which the ATRB had already denied the use of), the record shows the following: On 17 July 1995, petitioner filed an amended North Carolina Corporate Income Tax Return for the tax year of 1991 using the alternative bifurcated apportionment formula presented to and rejected by the ATRB. In this, petitioner sought a refund of $4,148,422 pursuant to N.C. Gen. Stat. § 105-266.1. By letter dated 17 July 1995, petitioner sought a refund of this amount pursuant to N.C. Gen. Stat. § 105-267 (2003). By letter dated 6 July 1996, the Department of Revenue denied petitioner's request for refund pursuant to N.C. Gen. Stat. § 105-267 as untimely. However, on 21 July 2000, petitioner was allowed an administrative tax hearing under N.C. Gen. Stat. § 105-266.1 which was then held on 16 August 2000 before the Secretary of Revenue. The Secretary's Final Decision pursuant to the administrative hearing, dated 29 December 2000, denied petitioner any refund on taxes paid for the year of 1991.

Concerning its request for judicial review of the ATRB decision, at issue in this case, petitioner filed a motion for a continuance on 31 January 2001. The motion was based on the following:

> To the extent that the Tax Review Board reverses the Final Decision dated December 29, 2000 and excludes the gain from the Iowa and Minnesota Divisions from Petitioner's North Carolina apportionable tax base on any ground, this proceeding would be mooted in its entirety. If, however, the Tax Review Board declines to reverse the Final Decision, Petitioner would *seek judicial review of that decision pursuant to N.C. Gen. Stat. § 150B-43.*
>
> In an effort to preserve the resources of the Court and the litigants and to simplify and streamline the issues for judicial review pursuant to N.C. Gen. Stat. § 150B-43, Petitioner therefore respectfully requests a continuance of this matter from the February 12, 2001 trial calender [sic] pending resolution by the Tax Review Board of the Request for Refund pursuant to N.C. Gen. Stat. § 266.1.

This motion was granted in an order filed 7 February 2001, and the future date was not rescheduled until notice was given for the Tax Review Board's ruling on the refund request pursuant to N.C. Gen. Stat. § 105-266.1. The record does not reflect the Tax Review Board's disposition in that matter. Finally, in an order filed 26 June 2003, the State's motion to dismiss the petition for judicial review of the ATRB decision was granted.

Petitioner now raises three issues in its appeal from the trial court's dismissal. First, petitioner alleges that North Carolina General Statutes and accompanying regulations authorize an appeal to superior court from a decision of the ATRB. Second, petitioner alleges that if there is not statutory authority for judicial review of a decision by the ATRB, then petitioner's rights to an ensured system of checks and balances under the North Carolina Constitution's, and the United States Constitution's guarantees of due process, equal protection, and rights under the commerce clause have been violated. Lastly, petitioner contends affirming the trial court's dismissal will deny petitioner its day in court because the parallel case seeking refund pursuant to an alternative statutory route has also been dismissed. We now address these issues in turn.

Judicial Review of an ATRB Decision

Petitioner contends there is statutory authority conferring jurisdiction for judicial review of a decision from the ATRB under the following: N.C. Gen. Stat. § 105-130.4(t)(6), N.C. Gen. Stat. § 105-241.4 (2003) as directed by N.C. Admin. Code tit. 20, r. 4.0310 (June 2004), and N.C. Gen. Stat. § 150B-43 of the Administrative Procedure Act ("APA"). We do not agree that any of these statutes provide for judicial review of a decision from the ATRB.

Before addressing the merits of the issue presented, it is helpful to understand the difference between the regular Tax Review Board and the ATRB. The composition of the "Tax Review Board" is set out in N.C. Gen. Stat. § 105-269.2 (2003):

> The Tax Review Board shall be composed of the following members: (i) the State Treasurer, ex officio, who shall be chairman of the board; (ii) the chairman of the Utilities Commission, ex officio; (iii) a member appointed by the Governor; and (iv) the Secretary of Revenue, ex officio, who shall be a member *only for the purposes stated in*

> *G.S. 105-122 and 105-130.4.* The member whom the Governor shall appoint shall serve for a term of four years and until his successor is appointed and qualified. The first such appointment shall be made for a term beginning on July 1, 1975.

(Emphasis added.) This composition is more clearly laid out in N.C. Admin. Code tit. 20, r. 4.0103 (June 2004):

> The title "Tax Review Board" actually refers to two boards, the regular Tax Review Board and the augmented Tax Review Board. The regular Tax Review Board is composed of the following members: the State Treasurer, ex officio, who shall be the Chairman of the Tax Review Board; the Chairman of the Utilities Commission, ex officio; and a member appointed by the Governor. The augmented Tax Review Board [ATRB] includes the Secretary of Revenue in addition to the other members of the regular Tax Review Board.

The relevant purpose of the regular Tax Review Board is to hear appeals from decisions of the Secretary of Revenue as an "appellate administrative agency having quasi-judicial authority" and holding such hearings strictly on the record of appeal from the Secretary. N.C. Admin. Code tit. 20, r. 4.0201 (June 2004). The relevant purpose of the ATRB is to "consider petitions from corporate taxpayers for use of alternate allocation formulas in determining tax bases for" income taxes. N.C. Admin. Code tit. 20, r. 4.0301 (June 2004). Concerning the ATRB, there is no reference to it as an appellate administrative agency.

The ATRB composition of the Tax Review Board (with the Secretary of Revenue as one of the decision makers for the Board) is used only in specific instances as required in

N.C. Gen. Stat. §§ 5 105-122 and 105-130.4. Therefore, as used throughout N.C. Gen. Stat. § 105-130.4(t), the "Tax Review Board" refers to the ATRB. However, because the ATRB initially reviews a corporate petitioner's claim for relief from its apportionment formula, not as an "appellate administrative agency," the function of ATRB is quite different, as are the implications of its decisions. The Secretary is actually a member of the ATRB, voting in the decision, and not a party by way of appeal before the regular Tax Review Board.

Turning now to the merits of petitioner's claim. N.C. Gen. Stat. § 105-130.4(t)(1) states in relevant part:

> If any corporation believes that the method of allocation or apportionment as administered by the Secretary has operated or will so operate as to subject it to taxation on a greater portion of its income than is reasonably attributable to business or earnings within the State, it may file with the Tax Review Board a *petition* setting forth the facts upon which its belief is based and its argument with respect to the application of the allocation formula. . . . At least three members of the Tax Review Board shall attend any hearing pursuant to such petition. In such cases, the Tax Review Board's membership shall be augmented by the addition of the Secretary, who shall sit as a member of the Board with full power to participate in its deliberations and decisions with respect to petitions filed under the provisions of this subsection. An informal record containing in substance the evidence, contentions and arguments presented at the hearing shall be made. All members of the *augmented Tax Review Board* shall consider such evidence, contentions and arguments and the decisions thereon shall

> be made by a majority vote of the *augmented Board.*

(Emphasis added.) When a corporation makes such a petition, N.C. Gen. Stat. § 105-130.4(t)(2) & (3) allows for the petitioner to have the ATRB consider the following: instances where a detailed accounting "of receipts and expenditures [] reflects more clearly than the applicable allocation formula prescribed by this section the income attributable to the business within this State," N.C. Gen. Stat. § 105-130.4(t)(2); or "the corporation shows any other method of allocation than the applicable allocation formula prescribed by this section reflects more clearly the income attributable to the business within this State." N.C. Gen. Stat. § 105-130.4(t)(3). To seek redress from an adverse decision from the ATRB, N.C. Gen. Stat. § 105-130.4(t)(6) provides:

> When the Secretary asserts liability under the formula adjustment decision of the [Augmented] Tax Review Board, an aggrieved corporation may *pay the tax and bring a civil action for recovery under the provisions of Article 9.*

(Emphasis added.)

In the case at bar, in lieu of application of the apportionment formula, petitioner petitioned the ATRB to consider both a separate accounting pursuant to N.C. Gen. Stat. § 105-130.4(t)(2), or in the alternative, a bifurcated apportionment formula pursuant to N.C. Gen. Stat. § 105-130.4(t)(3). The ATRB denied the petitioner's request, finding petitioner had not overcome the statutory presumption that the appropriate apportionment formula reasonably attributes the corporation's income earned in the state. N.C. Gen. Stat. § 105-130.4(t)(4). Petitioner contends that N.C. Gen. Stat. § 105-130.4(t)(6) creates jurisdiction in the superior court to give appellate review of the ATRB's decision. We do not agree.

N.C. Gen. Stat. § 105-130.4(t)(6) directs the aggrieved taxpayer to pay any tax liability, and bring a civil action under Article 9 of North Carolina's Tax Code. Following the language of that statute, petitioner was directed to the provision of Article 9 of the tax code for an "Action to recover tax paid." N.C. Gen. Stat. § 105-241.4; *see also,* N.C. Admin. Code tit. 20, r. 4.0310.[2] In relevant part, this statute states:

> Within 30 days after notification of the Secretary's decision with respect to liability under this Subchapter or Subchapter V, any taxpayer aggrieved thereby, in lieu of petitioning for administrative review thereof by the Tax Review Board under G.S. 105-241.2, may pay the tax and bring a civil action for its recovery as provided in G.S. 105-267.

N.C. Gen. Stat. § 105-241.4. Following the language of this statute, a petitioner is directed to N.C. Gen. Stat. § 105-267 (2003) which, in relevant part, states:

> Whenever a person has a valid defense to the enforcement of the collection of a tax, the person

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[2] We note that the State argued in its brief that N.C. Gen. Stat. § 105-241.4 does not apply at all to this case because it is limited to when taxpayers have received administrative review. This is not correct. We read the plain language of N.C. Gen. Stat. § 105-241.4 as a clear and alternate route of recovery that allows a taxpayer to bypass, or cut short, administrative review under N.C. Gen. Stat. § 105-241.2 and N.C. Gen Stat. § 105-241.3, and proceed to litigate the tax liability in superior court.

> shall pay the tax to the proper officer, and that payment shall be without prejudice to any defense of rights the person may have regarding the tax. At any time within the applicable protest period, the taxpayer may demand a refund of the tax paid in writing from the Secretary and if the tax is not refunded within 90 days thereafter, may sue the Secretary in the courts of the State for the amount demanded. . . . The protest period for all other taxes is three years after payment.
>
> The suit may be brought in the Superior Court of Wake County, or in the county in which the taxpayer resides at any time within three years after the expiration of the 90-day period allowed for making the refund. If upon the trial it is determined that all or part of the tax was levied or assessed for an illegal or unauthorized purpose, or was for any reason invalid or excessive, judgment shall be rendered therefor, with interest, and the judgment shall be collected as in other cases. The amount of taxes for which judgment is rendered in such an action shall be refunded by the State. G.S. 105-241.2 provides an alternate procedure for a taxpayer to contest a tax and is not in conflict with or superseded by this section.

Therefore, ultimately N.C. Gen. Stat. § 105-267 is the relevant "blueprint" for a petitioner's relief from an adverse decision by the ATRB. Additionally, a corporation is not required to first petition the ATRB before pursuing redress under N.C. Gen. Stat. § 105-267. *Oil Corp.*, 267 N.C. at 19, 147 S.E.2d at 526. The plain, unambiguous language of that statute requires the petitioner to pay the tax and file a civil action in superior court against the Secretary. Pursuant thereto, a "trial" is held to determine whether the Secretary's tax assessment was correct. Therefore, the superior court determines this issue pursuant to its original jurisdiction. *Duke v. Shaw, Commissioner of Revenue,* 247 N.C. 236, 240, 100 S.E.2d 506, 508-09 (1957) (where our Supreme Court explained that the only time the superior court has appellate jurisdiction in reviewing the Secretary's tax assessment is when the regular Tax Review Board, upon its review of the Secretary's final decision, renders a decision pursuant to N.C. Gen. Stat. § 105-241.2 and N.C. Gen. Stat. § 105-241.3.).

The tax regulation for "Appeals from the Decision" of the ATRB, relied on heavily by petitioner, at first blush purports to grant appellate jurisdiction in the superior court to review a decision by the ATRB. It states:

> When the Secretary of Revenue asserts liability under the formula adjustment decision of the board, an aggrieved corporation may pay the tax and bring a civil action for recovery under the provisions of G.S. 105-241.4. On appeal the superior court will view the hearing record of the augmented board. This record will consist of claimant's petition, brief, evidence, documents, and papers and the final decision of the board.

N.C. Admin. Code. tit. 20, r. 4.0310. However, a close reading of this regulation reveals that it is inconsistent. The first half of the regulation requires the aggrieved corporation to pay its tax and bring a civil action pursuant to N.C. Gen. Stat. § 105-241.4. As set out above, this civil action is to be filed in accord with N.C. Gen. Stat. § 105-267 and is therefore before the superior court pursuant to its original jurisdiction. However, the last two sentences of N.C. Admin. Code tit. 20, r. 4.0310 seem to confer appellate jurisdiction upon the superior court, where the court will consider only the record of the ATRB hearing. We can find no statutory authority for the creation of this appellate jurisdiction, and it conflicts with the regulation's direction to N.C. Gen. Stat. § 105-241.4 and ultimately N.C. Gen. Stat. § 105-267. *See* N.C. Gen. Stat. § 150B-21.9(a)(1) (Regulations must be "within the authority delegated to the agency by the General assembly."). To the extent this regulation is inconsistent with its statutory authority, we hold it to be invalid and without legal effect.

Additionally, petitioner argues that N.C. Gen. Stat. § 150B-43 of the APA provides appellate jurisdiction in the superior court over decisions by the ATRB. However, in light of the direction of N.C. Gen. Stat. § 105-130.4(t)(6) to N.C. Gen. Stat. § 105-241.4 after paying the tax liability, we do not agree. Generally, a taxpayer contesting liability has two routes in seeking relief. The first is by way of administrative review: without paying the contested tax liability, a taxpayer must obtain a hearing before the Secretary of Revenue, and assuming the party is aggrieved, the regular Tax Review Board will review the Secretary's final decision. *See* N.C. Gen. Stat. § 105-241.2. If an adverse decision from the regular Board is received, then the taxpayer may pay the tax and penalties, and appeal to the superior court for *appellate review* of the regular Board's decision pursuant to Article 4 of N.C. Gen. Stat. § 150B. N.C. Gen. Stat. § 105-241.3. This is also explained in the regulations for the regular Tax Review Board:

> Any taxpayer aggrieved by the decision of the *regular board* may either pay the tax, penalties and interest asserted to be due or may file with the Secretary of Revenue a bond in the amount due and then appeal the decision of the board to

> the superior court under the provisions of Article 4 of Chapter 150B of the General Statutes.

N.C. Admin. Code tit. 20, r. 4.0208 (June 2004) (emphasis added). The second route in which a taxpayer may seek relief is to bypass administrative review, pay the tax liability immediately, and bring a civil action for its recovery pursuant to N.C. Gen. Stat. § 105-267. N.C. Gen. Stat. § 105-241.4. There is also a hybrid of these two routes, such that, in lieu of appealing for superior court review of the regular Tax Review Board's decision made pursuant to N.C. Gen. Stat. § 105-241.2, the taxpayer can pay the tax and file a civil action for recovery under N.C. Gen. Stat. § 105-241.4 in the superior court's original jurisdiction.

In sum, administrative review is a process invoked by receiving a final decision from the Secretary, and appealing that decision to the regular Tax Review Board which then renders a final decision. *See Duke*, 247 N.C. at 240, 100 S.E.2d at 508-09. The administrative review route is not an option for corporations contesting the applicable apportionment formula before the ATRB, as the plain language of N.C. Gen. Stat. § 105-130.4(t)(6) requires aggrieved corporations to "pay the tax and *bring* a civil action," thus directing them to N.C. Gen. Stat. § 241.4 (emphasis added).[3] Additionally, the APA provides for a right of judicial review under its provisions when

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[3] This is logical when considering that it is the Secretary that augments the Tax Review Board for petitions under N.C. Gen. Stat. § 105-130.4(t). Because both the members of the regular Tax Review Board and the Secretary consider the corporation's petition before the ATRB, it would be superfluous to revert their decision back into the administrative process and before the same decision makers.

> [a]ny person who is aggrieved by the final decision in a contested case, and who has exhausted all administrative remedies made available to him by statute or agency rule . . . unless adequate procedure for judicial review is provided by another statute in which case the review shall be under such other statute.

N.C. Gen. Stat. § 150B-43. Therefore, we cannot find appellate jurisdiction in the superior court for the ATRB's decision, which is allowed only in the route statutorily foreclosed to these contesting corporations and an alternative route of judicial review is available.

We find support not only in the plain language of N.C. Gen. Stat. § 105-130.4(t)(6), N.C. Gen. Stat. § 105-241.4, and N.C. Gen. Stat. § 105-267, all directing an aggrieved corporation to file a civil action, but additionally in the statutory language setting the parameters of the regular Tax Review Board when conducting hearings:

> The chairman or any two members, upon five days' notice, may call a meeting of the Board; provided, any member of the Board may waive notice of a meeting and the presence of a member of the Board at any meeting shall constitute a waiver of the notice of said meeting. A majority of the members of the Board shall constitute a quorum, and *any act or decision of a majority of the members shall constitute an act or decision of the Board, except for the purposes and under the conditions of the provisions of G.S. 105-122 and 105-130.4.*

N.C. Gen. Stat. § 105-269.2 (emphasis added). The language of this statute suggests that decisions by the ATRB pursuant to petitions brought under N.C. Gen. Stat. § 105-130.4(t), do not "constitute an act or a decision by the [Tax

Review] Board." *Id.* This is consistent with the fact that aggrieved corporations are not directed to the administrative appeal route as laid out above, because as this statutory language suggests, they have not been rendered an administrative "decision" by the regular Tax Review Board which would be capable of administrative review. Once the ATRB decision to deny variation of a corporate statutory apportionment formula has been rendered, petitioner must pay its liability under the presumptive formula, though it believes such payment may be unconstitutional. Our Supreme Court has long held that N.C. Gen. Stat. § 105-267 is the appropriate procedure under which to challenge an income tax not attributable to North Carolina and which the State may not constitutionally tax. *Oil Corp.,* 267 N.C. at 20, 147 S.E.2d at 526. "The law does not contemplate that administrative boards shall pass upon constitutional questions." *Id.*; *see Johnston v. Gaston County,* 71 N.C. App. 707, 713, 323 S.E.2d 381, 384 (1984), *disc. review denied,* 313 N.C. 508, 329 S.E.2d 392 (1985); *Meads v. N.C. Dep't of Agric.,* 349 N.C. 656, 669-70, 509 S.E.2d 165, 174 (1998). Therefore, we hold such challenges must be heard *de novo* in superior court pursuant to that court's original jurisdiction.

In conclusion, we hold that there is no administrative appeal process from decisions made by the ATRB, but, as directed by N.C. Gen. Stat. § 105-130.4(t)(6), N.C. Gen. Stat. § 105-241.4, and N.C. Gen. Stat. § 105-267, the corporate tax must be paid and recovery sued for in superior court.

All assignments of error raised by this issue are overruled.

State and Federal Constitutional Claims

Next, petitioner contends that if decisions from the ATRB pursuant to N.C. Gen. Stat. § 105-130.4(t) are unreviewable by the superior court, then the statute violates petitioner's state and federal constitutional rights of due process. Petitioner is correct in its assertion that a taxpayer must be given both a fair opportunity to challenge the tax and a clear and certain remedy for any erroneous and unlawful tax collection. *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 51-52, 110 L. Ed. 2d 17, 45 (1990). However, pursuant to the analysis below, we hold that the petitioner has been afforded both a fair opportunity to challenge the tax and a clear and certain remedy.

"The taxpayer asserting nonliability may be afforded constitutional protection by *either* administrative or judicial review." *Kirkpatrick v. Currie, Comr. of Revenue*, 250 N.C. 213, 215, 108 S.E.2d 209, 210 (1959). There is no requirement the taxpayer be afforded both. As held above, we have determined that an aggrieved party from the ATRB decision is ultimately directed to the exclusive redress as provided in N.C. Gen. Stat. § 105-267. In *Kirkpatrick*, our Supreme Court held that "[t]his statute permitting payment to be made under protest with a right to bring an action to recover the monies so paid is constitutional and accords the taxpayer due process." *Id.*

When an aggrieved corporation petitions the ATRB to review an alleged unconstitutional application of the relevant apportionment formula, as occurred in the case at bar, they are challenging the lawfulness of the statutory apportionment formula either generally, or as applied to them. In *Coca-Cola Co. v. Coble, Sec. of Revenue*, 293 N.C.

565, 568, 238 S.E.2d 780, 783 (1977), the Supreme Court held that, where a tax is challenged as unlawful rather than excessive or incorrect, the appropriate remedy is to bring suit under N.C. Gen. Stat. § 105-267; *see also Oil Corp.*, 267 N.C. at 20, 147 S.E.2d at 526 (where the Court held N.C. Gen. Stat. § 105-267 is the appropriate statute to test the constitutionality of an income tax statute or its application). Therefore, when choosing to petition the ATRB to challenge the legality of the statutory apportionment formula for a specific tax year, an aggrieved petitioner is afforded due process in seeking relief from an adverse decision by way of a *de novo* action in superior court brought pursuant to its original jurisdiction. Petitioner's constitutional challenges would have merit only if, after a decision by the ATRB was rendered, they were completely left without some redress.

All assignments of error raised by this issue are overruled.

Petitioner's Day in Court

Petitioner contends that, in affirming the trial court's dismissal based on lack of subject matter jurisdiction, we have denied the corporation its day in court to contest the constitutionality of the tax liability asserted against them for the year of 1991. We do not agree.

Jurisdiction of the court over the subject matter of an action is the most critical aspect of the court's authority to act. *Harris v. Pembaur*, 84 N.C. App. 666, 667, 353 S.E.2d 673, 675 (1987). Subject matter jurisdiction refers to the power of the court to deal with the kind of action in question. *Id.* Appellate jurisdiction of the superior court is derivative from an independent tribunal of original jurisdiction. *See, e.g., In re Will of Hine*, 228 N.C. 405, 411, 45 S.E.2d 526, 530 (1947) (superior court has appellate jurisdiction derived from the clerk of the superior court in the exercise of probate jurisdiction); *In re Simmons*, 266 N.C. 702, 706-07, 147 S.E.2d 231, 234 (1966) (For the appointment and removal of guardians, the appellate jurisdiction of the superior court is derivative and appeals present for review only errors of law committed by the clerk); and *Sherrill v. Town of Wrightsville Beach*, 76 N.C. App. 646, 649, 334 S.E.2d 103, 105 (1985) (Under N.C. Gen. Stat. § 160A-388(e), the superior court, and this Court, through our derivative appellate jurisdiction, had the statutory power to review only the issue of whether a variance was properly denied. The constitutionality of the zoning ordinance from which the variance was sought was not properly part of the proceedings since the denial of the variance never addressed the validity of the zoning ordinance.).

We have held in this opinion that there is no right to judicial review of a decision by the ATRB. As provided in the analysis above, the superior court lacks any derivative appellate jurisdiction from the ATRB. Therefore, the trial court is without jurisdiction to review an appeal from the ATRB, and the petition for such review was properly dismissed. Petitioner's day in court was available pursuant to N.C. Gen. Stat. § 105-267, in the superior court's original jurisdiction, by bringing a civil action against the Secretary for a refund of the paid income tax. The record indicates that petitioner has initiated such a claim. Issues related to that action, specifically as to whether or not it was timely filed, are not before this Court, and we have no jurisdiction to review them in this appeal. Petitioner's day in court on those issues should be raised in a *de novo* hearing in superior court, or on appeal from any final decision from that court.

After careful consideration of the issues raised by petitioner properly before our Court, we affirm the trial court's dismissal of this case based on its lack of subject matter jurisdiction to review a decision by the ATRB.

Affirmed.

Judges McGEE and ELMORE concur.

APPENDIX L

No. 632P04 TENTH DISTRICT

SUPREME COURT OF NORTH CAROLINA

****

(In the Matter of: Central Telephone)

IN THE MATTER OF: THE PETITION OF CENTRAL TELEPHONE COMPANY CONCERNING THE ALLOCATION FORMULA FOR CORPORATE INCOME TAX PURPOSES FOR THE YEAR ENDED DECEMBER 31, 1991

appealed by Central Telephone Company

From NC Court of Appeals
(COA03-1313)
From Wake
(95CVS6955)

****

ORDER

Upon consideration of the notice of appeal from the North Carolina Court of Appeals, filed by the Petitioner (Central Telephone Company) on the 21st day of December 2004 in this matter pursuant to G.S. 7A-30, and the motion to dismiss the appeal for lack of substantial constitutional question filed by the Respondent's (Secretary of Revenue, Tolson), the following order was entered and is hereby certified to the North Carolina Court of Appeals: the motion to dismiss the appeal is

"Allowed by order of the Court in conference, this the 3rd day of February 2005.

s/ Newby, J.
For the Court"

Upon consideration of the petition filed on the 21st day of December 2004 by Petitioner in this matter for discretionary review of the decision of the North Carolina Court of Appeals pursuant to G.S. 7A-31, the following order was entered and is hereby certified to the North Carolina Court of Appeals:

> **"Denied by order of the Court in conference, this the 3rd day of February 2005.**
>
> **s/ Newby, J.**
> **For the Court"**

WITNESS my hand and the seal of the Supreme Court of North Carolina, this the 9th day of February 2005.

Christie Speir Cameron
Clerk, Supreme Court of
North Carolina

/s/ Shaula A. Brannan
Shaula A. Brannan
Assistant Clerk

[SEAL]

Copy to:

North Carolina Court of Appeals
Mr. Ralph A. White, Appellate Reporter (By E-Mail)
Mr. Jasper L. Cummings, Jr., Attorney at Law, For Central Telephone Co.
Mr. Paul H. Frankel, Attorney at Law, For Central Telephone Co.
Mr. Craig B. Fields, Attorney at Law, for Central Telephone Co.
Ms. Roberta Moseley [Nero], Attorney at Law, for Central Telephone Co.
Ms. Kay Linn Miller Hobart, Assistant Attorney General, For E. Norris Tolson

West Publishing Company (By E-mail)
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